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U.S. TRADE RELATIONS WITH CHINA

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JULY 25, 2007

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

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WEDNESDAY, JULY 25, 2007

U.S. SENATE,
SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:33 p.m. in room SD–562, Dirksen Senate Office Building, Hon. Byron L. Dorgan, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. I'm going to call the hearing to order. This is the hearing of the Subcommittee on Interstate Commerce, Trade, and Tourism of the Senate Commerce Committee. Today we're holding the second in a series of hearings that will examine our country's trade policies. Our first hearing was in the month of April. We looked at the general direction of trade policies. Today we'll look at our trading relationship with China, the country with which we have the largest trade deficit that one nation has ever experienced with another.

I indicated at the last hearing that I'm in favor of trade and plenty of it, but I demand that it be fair. And, we have a trade circumstance in this country that is unfair in so many ways and what has happened to us is we have seen the dramatic growth of a trade deficit that is going to injure this country.

Let me just say with respect to China, when the United States granted permanent normal trade relations with China in the year 2000 our merchandise trade deficit with China was $83 billion a year. By last year, that trade deficit had exploded to $233 billion. For every six dollars of merchandise we purchase from the Chinese, the Chinese buy one dollar of merchandise from us. That is a staggering indictment of a trade policy, regrettably, that I believe is not fair trade and reflects, I believe, a wide range of problems as well. Those problems include vast intellectual property theft and piracy, currency manipulation, unfair barriers against U.S. exports, and an unfair playing field in which U.S. jobs go to China because of sweat shop conditions, a subject on which we will hold a future hearing as well.

Recently we read of a decision to begin importing cars into this country from China and the decision to import an automobile from China into this country is an interesting one, because I have raised questions about bilateral automobile trade. It is interesting to me that the circumstances of bilateral automobile trade in this country are such that when the Chinese automobiles come to our shore they will be assessed a 2.5 percent tariff. By mutual consent, if we were to export automobiles to China, China will impose a 25 percent tariff.

Now, think of that. A country with whom we have a $200-plus billion trade deficit; we have agreed that on bilateral automobile trade it's just fine for them to enact a tariff that is ten times ours. That is unbelievably ignorant of our economic well-being in my judgment. I use that as one small example. I will describe others today.

But part of the problem is unfair trade from a trading partner that does not own up to the rules of trade. Part of it is our own incompetence in negotiating bad trade agreements. But a significant part of it as well, the overlapping portion of it is the mantra that we keep chanting in this country about free trade that turns out to be so fundamentally unfair to this country's economic interests.

It's interesting to me that there seems to be very little interest or concern by those that support the current trade policy, even as the evidence mounts with dramatic, increasing trade deficits that this trade policy is a failure.

So we will have a good discussion about a range of issues and solutions. We are joined today by the Ranking Member, Senator DeMint, on this Subcommittee. I've invited Senator Brown, who has written extensively, in fact written a book on this subject. Senator Sanders had asked to be the opening witness and we will hear from Senator Sanders before we go to the list of the witnesses that we've also invited.

I want to mention that in addition, after Senator Sanders has testified, we will hear from the Honorable David Spooner, the Assistant Secretary of Commerce for International Trade Administration, U.S. Department of Commerce; Mr. James Hoffa, General President, International Brotherhood of Teamsters; Brian O'Shaughnessy, Chairman and CEO and President of Revere Copper Products in Rome, New York; Mr. Scott Paul, Executive Director, Alliance for American Manufacturing; and Mr. Robert Nichols, President and COO of Financial Services Forum. I appreciate the witnesses coming today and let me call on my colleague Senator DeMint.

STATEMENT OF HON. JIM DEMINT, U.S. SENATOR FROM SOUTH CAROLINA

Senator DEMINT. Thank you, Mr. Chairman. I appreciate you holding the hearing today. China is a critical trading partner and we should continually examine the relationship that we have with them as well as the trade agreements, as you've mentioned.

As most of us know, China is the world's fourth largest economy, likely to become the world's third largest economy this year. More importantly, it's a rapidly developing country, with 1.3 billion consumers, with a rapidly growing middle class. While we export nearly the same amount of goods to China as we do to Japan, Japan is a developed country whose population is ten times smaller than China's. As we develop a strong relationship with China, the market for American products will grow exponentially when the Chinese middle class matures and they begin to consume goods on a similar scale to other developed countries like Japan.

But unfortunately, I don't think we are going to discuss the opportunities available in China at today's hearing. I fear we're going to spend a good portion of this afternoon attacking the Chinese. I anticipate that some of my colleagues will express concern about subsidies and frustrations about currency issues, all as a foundation for taking action against China—revoking permanent normal trade relations, levying onerous duties, or some other creative form of punitive trade policy.

In the 1980s and early 1990s, we heard a similar call for protectionism, protectionist measures, but then the Japanese were the source of our woes. Today it's the Chinese, and tomorrow maybe it will be the Indians. Before we blame some foreign capital for our woes, maybe we should take the time to examine what we're doing wrong at home that is making us less competitive.

America has a legal system where trial lawyers rush to the courthouse, litigating every little difference and sucking massive amounts of productive energy out of our economy. The United States tort system costs Americans over $245 billion annually. It costs the average small business $150,000 a year. This is money that could have been better spent conducting research and development, hiring new staff, or finding opportunities in new markets, and even lowering the price of our goods abroad. Instead, this money was needlessly wasted enriching trial attorneys.

If the drag on American competitiveness from an abuse-prone tort system isn't enough, our byzantine tax system compounds the problem. Individuals and businesses in the United States spend over 6 billion hours a year complying with the Federal income tax code. They waste over $250 billion annually just making sure they fill out the forms correctly. And this is all before they open their checkbooks and write a check to Uncle Sam.

Regardless of whether someone is a supporter of big government spending and high taxes or wants a lean, efficient government, you should be appalled that the tax code forces Americans to waste over 6 billion hours a year, the yearly output of 3 million Americans, just filling out tax forms. Just think of what a shot in the arm it would be for American competitiveness if we unleashed the innovative and creative energies of 3 million Americans.

After American companies have been squeezed by frivolous lawsuits and burdensome taxes, they're faced with the high cost of regulation. Businessmen around the country are worried every day that their shop is going to be fined or closed down because they've somehow run afoul of the minutia in some Federal regulation. They're forced to spend money that should be spent innovating on compliance officers who can protect them from the threat of an OSHA audit.

The costs last year of regulatory compliance exceeded $1.14 trillion. Even if half of all regulations are useful and necessary, there is still over $500 billion in productive energy being sucked out of our economy by government regulations each year.

Colleagues, Ross Perot famously described what he thought would be a "giant sucking sound" of jobs from America being shifted overseas. While he was wrong about the impact of NAFTA, he was right that there is a giant sucking sound. The giant sucking sound we hear is the sound of Washington sucking creative energy out of the American economy in the form of energy wasted filling out tax forms and complying with burdensome regulations. There's a giant sucking sound of trial lawyers sucking billions of dollars out of the pockets of American companies in the form of frivolous lawsuits. And maybe most troubling, there's a giant sucking sound of the big-spending politicians here in Washington sucking billions of dollars out of the pockets of families and businesses to pay for their big government initiatives.

I'm sure this afternoon we're going to hear a chorus of complaints about the Chinese. We'll hear all the stories about how the Chinese are eating our lunch and how the plight of the American worker is in peril. Many fingers will be pointed at Beijing and much scorn will certainly be heaped upon the People's Republic of China. But I would submit to you that you're pointing the finger at the wrong capital. You need to look no further than this body to find where fault lies. It's the U.S. Government that has let the lawyers run wild, the U.S. Government that has promulgated nearly 75,000 pages of Federal regulation, and the U.S. Congress that has drafted an Internal Revenue Code that is thousands of pages long and siphons billions of dollars out of our economy each year.

Colleagues, American competitiveness is at stake, but it's not because some foreign government is trying to stick it to America. It's because America's government has decided that it wants to stick it to business and make them shoulder an ever greater burden from the government. If government would just step back and lessen the burden on American businesses and innovators, the impact on domestic jobs and international commerce would be stunning.

I thank the Chairman for taking the time to hold this hearing and I look forward to comments from the witnesses.

Senator DORGAN. Well, Senator DeMint, we are going to have an interesting hearing indeed. I think—let me put up a chart I didn't put up. You look at that chart, I think it's very hard to be one of the blame America first crowd. That chart has nothing to do with what's wrong with America. That chart has everything to do with an imbalance in trade and unfair trading practices. But we will have an interesting time, apparently, discussing these issues. Your opening statement did not——

Senator DEMINT. I've got some charts of my own.

Senator DORGAN. Your opening statement did not discuss trade, but I'm happy also to discuss the economy and a range of other issues that you have raised. At any rate, it'll be an interesting afternoon.

Senator Brown?

STATEMENT OF HON. SHERROD BROWN, U.S. SENATOR FROM OHIO

Senator BROWN. Thank you, Mr. Chairman, and thank you, Senator DeMint, for allowing me to sit in on this Committee, of which I'm not a member, but have a burning interest, as Senator Dorgan has, on trade issues, and as Senator Sanders has led in his years in the House.

I remember back in the late 1990s when the CEO's of America's largest companies wandered the halls of Congress in the House at least. Typically, CEOs of that stature didn't stop in the offices of ordinary, everyday members from Vermont and Ohio. They went to the leadership offices. But in those days, because PNTR was so important to the largest companies in this country, they stopped in individual offices. And they continued day after day, CEO after CEO, talking about how they couldn't wait to have access to one billion Chinese consumers.

What they failed to mention is that they really had way more interest in one billion Chinese workers, and that's what fundamentally the issue was about in China PNTR. They told us that PNTR would ensure China's move to more of a market economy. They said it would help promote growth and opportunity for the people of both our nations. Unfortunately, on both counts they proved wrong.

Experts, including James Mann of the John Hopkins School of Advanced International Studies, who ran the Beijing Bureau for several years for a major American newspaper, have stated that the argument used to pass the China trade deal was a false paradigm. Eating at McDonald's and wearing blue jeans does not make China a vibrant democracy. The word from the business elite in this country and from the newspaper publishers of this country is, if you can tell the difference, has been over and over that the more we engage China economically that democracy automatically would follow, and there has simply been no evidence of that and the American public's on to that.

In addition, the Economic Policy Institute recently reported, as Senator Dorgan suggested, on the trade deficit, nearly 2 million lost U.S. jobs since China's admission to the WTO. My state, one of the hardest hit, has lost somewhere in the vicinity of 66,000 jobs directly attributed to Chinese—to our relationship with China.

We know that what's happened to manufacturing is a national security issue that as our manufacturing base declines our ability to defend ourselves declines, especially in the steel industry and especially in big manufacturing, if you will. And we are giving away much of our technology. We know about the Boeing deals. We know about Westinghouse. We give away much of our technology to another country that's not necessarily a friendly country.

I am particularly amused by my colleague from South Carolina's discussion about regulation. To be sure, we have more regulation in this country. We probably are less likely in our country to have contaminated pet food, contaminated toothpaste, toys like Thomas the Tank, tires that malfunction, because we do in fact have a regulatory structure in our country whose primary responsibility, in spite of efforts by people perhaps of Senator DeMint's philosophy to undercut those regulations and to weaken those protections, from consumer product safety to OSHA to the EPA, American values to protect our middle class and protect our people and protect our families from unsafe food products and unsafe toys and our children and all of that.

I would never trade our regulatory structure for the Chinese regulatory structure. It's simply not a surprise—it came as a surprise to none of us who have been skeptical of the trade relationship between the United States and China that China has sent us products that are unsafe, whether it's vitamin C or toothpaste or pet foods. We know that when a country is that wide open with no real safety and health and food safety and health regulations that that kind of wide-open trade policy, as we cut the number of inspectors at our borders, that that's going to happen.

Basically, what we've had is free trade on the cheap. When you have free trade on the cheap, you end up with less environmental protection and less food safety.

I thank the Chairman.

Senator DORGAN. Senator Brown, thank you very much.

I know Senator Sanders has to leave to be at another Committee. But Senator Sanders, you have asked to testify. We're very much appreciative of your being here, and why don't you proceed. We will by consent ask that the full statements of the witnesses and the full opening statements of the panel will be included in their entirety in the record.

STATEMENT OF HON. BERNARD SANDERS, U.S. SENATOR FROM VERMONT

Senator SANDERS. Thank you very much, Mr. Chairman, and thank you for your work and Senator Brown's work in highlighting an issue that in their guts the American people understand, but has not yet permeated this institution or certainly the corporate media.

We have got to ask some hard questions and that is why is it that the middle class today is shrinking despite an explosion of worker productivity and technology? Why is it that since Bush has been President, five million more Americans have slipped into poverty? Now, I don't think trade is the only reason that the middle class is shrinking and poverty is increasing, but it is certainly a major reason.

Mr. DeMint, I am not here to attack the Chinese government. I am here to talk about what our government has done. The Chinese government is doing its best to represent their people and some of us would like to see our government do its best to represent the working people of this country rather than just the CEOs of large corporations, although I must say I do find it interesting that not so many years ago many of our conservative Republican friends were telling us how we had to spend tens and tens of billions of dollars to oppose and fight authoritarian communism, and now many of those same people in Congress and in corporate America are telling us what a wonderful country an authoritarian communist nation is.

The bottom line of this discussion is, Senator Brown has indicated, is that we are in a race to the bottom. I would love somebody to explain to me how free trade means forcing American workers to compete against people who make 20 cents an hour, 30 cents an hour, 50 cents an hour, who go to jail when they talk about democracy in their country, who go to jail when they try to form a union. That to me is not anything having to do with free trade. That is an effort to force a race to the bottom by which American workers are seeing in many cases a decline in their wages and in their standard of living.

Here's what we're looking at in America today. Eighty percent of the toys sold in the United States are made in China. Ninety percent of the vitamin C made in America is made in China. Eighty percent of the footwear in this country is made in China. It is estimated in a few years 90 percent of the U.S. furniture production will be moved to China. Eighty-five percent of the bikes are made in China.

As Senator Dorgan indicated, this alliance between Chrysler and Chery where for the first time automobiles will be manufactured in China that can be sold in the United States could likely mean the end for all intent and purposes of the automobile industry in this country. To my mind, the time is long overdue for this Congress to stand up for the working families of America, not just the CEOs of large corporations and all of the campaign contributions that influence what we do here.

Trade is an enormously important issue if we are going to protect the middle class. All of us, as Senator Dorgan indicated, believe in trade and plenty of it. But we believe that there has got to be a level playing field and not a process by which we race to the bottom.

So I want to congratulate Senator Dorgan for raising this issue. I want to conclude by saying we're not just talking about blue collar manufacturing jobs. We're talking about white collar information technology jobs. And if we don't get this issue right, the fate of the middle class in this country will be very uncertain to say the least.

Senator, thank you very much.

Senator DORGAN. Senator Sanders, thank you very much. I understand you have to be at another hearing. Thank you very much for your testimony.

I would like to call up the other witnesses and, with consent, I would like to ask the Honorable David Spooner, Assistant Secretary of Commerce for International Trade Administration, to come forward. Mr. Spooner, if you would sit on the right side. I want to ask the other witnesses to come up as well. We will ask you to testify first and if we have questions of you we will ask those questions. Then I will hear from the other witnesses. But I thank you very much for being here.

Mr. Hoffa, if you would come to the witness table, the General President of the International Brotherhood of Teamsters. Mr. Brian O'Shaughnessy, the Chairman, CEO, and President, Revere Copper Products, Inc., in Rome, New York; Mr. Scott Paul, the Executive Director, Alliance for American Manufacturing; and Mr. Robert S. Nichols, President and COO, Financial Services Forum.

Let me thank all of you for being here today. I know some of you have come some distance, and this is a very important topic, one that people feel passionately about.

Mr. Spooner, you're coming to us from the U.S. Department of Commerce. We appreciate your willingness to be here. You have submitted your testimony previously. We would ask that you summarize. The testimony of all of the witnesses will be included in the record in their entirety.

Mr. Spooner, you may proceed.

STATEMENT OF HON. DAVID M. SPOONER, ASSISTANT SECRETARY OF COMMERCE FOR IMPORT ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

Mr. SPOONER. Thank you, Mr. Chairman, Senator DeMint, and Senator Brown. I'm pleased to be here today to share some thoughts on the United States' trade relationship with China. American companies face a number of challenges as they try to compete with China, from market barriers and intellectual property issues to unfair trade practices. Nevertheless, the relationship with China is generally a positive one, with benefits to U.S. manufacturers, farmers, service industries, and consumers.

For 35 years it has been the policy of the United States across every administration to engage China as it moves toward market economics. The United States derives clear benefits from trading with China and by doing so within a framework which requires China to abide by international obligations. This policy culminated in China's accession to the WTO in 2001, so that for the first time China had both rights and responsibilities in the international trading system.

U.S. exports to China are booming. China is our fastest growing major export market and is now our fourth largest overall export market. U.S. exports to China totaled $55 billion in 2006, up 32 percent from the prior year. U.S. exports to China are now greater than U.S. exports to India, Brazil, and France combined. Our companies and consumers derive benefits from imports from China as well.

At the same time, we face real challenges with our trade relations with China. To use one example, China is on the path of creating global oversupply in the steel industry. Chinese steel capacity is now greater than that of the U.S., Europe, and Japan combined. Further, we have recently faced some serious challenges regarding the safety of Chinese imports. Challenges which the administration is addressing by establishing an inter-agency working group on import safety, to be chaired by the Secretary of Health and Human Services. The working group will identify where improvements can be made and ensuring the safety of imports through cooperation with Federal, State, and local government agencies, foreign governments, and U.S. importers.

Commerce is addressing these and other challenges with a multipronged approach to bring about positive changes in China's trade policies, regulations, and practices to level the playing field. Commerce's China efforts fall into three general areas: tough-minded negotiations to achieve better market access, aggressive enforcement of our trade laws to fight dumping and subsidies, and high energy trade promotion to help U.S. companies compete and win in the Chinese marketplace.

Our negotiations take place primarily through the Joint Commission on Commerce and Trade, which meets once a year and is chaired by the Commerce Department and USTR, with high level participation from USDA, and the Strategic Economic Dialogue led by the Treasury Department. Because of our aggressive trade enforcement, 27 percent of our antidumping duty orders are in imports from China, and recently we preliminarily determined to reverse a 23-year-old government policy by applying our anti-subsidy law to China. Indeed, I was in China last week to lead our on-the-ground investigation of subsidies and the rest of the China team is still in China conducting verification and will return to the United States at the end of this week. We can and should remedy subsidies in China when they exist and it's in our mutual interest to do so.

Our export promotion activity means that we devote more personnel and activity to China than to any other market, with substantial benefits to U.S. exporters. The Commerce China team, a staff of 130 supported by our China trade specialists in Washington and field offices throughout the United States, work directly with companies, particularly small and medium size enterprises, interested in exporting to China to develop market opportunities, facilitate business, and to solve problems.

We believe this threefold strategy provides the right mix to help American workers and to help China continue on the path of reform and to become a responsible stakeholder in the global economy.

Thank you, Mr. Chairman, and I'm happy to take any questions.

[The prepared statement of Mr. Spooner follows:]

PREPARED STATEMENT OF HON. DAVID M. SPOONER, ASSISTANT SECRETARY OF COMMERCE FOR IMPORT ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

Mr. Chairman, Senator DeMint, Members of the Subcommittee, I am pleased to be with you today to share some thoughts on the United States' trade relationship with China. In our view, this relationship is in general a positive one, with benefits to U.S. manufacturers, workers, farmers, ranchers, and service providers. However, at the same time, we recognize that U.S. companies face a number of challenges as they try to compete in China, from market barriers and intellectual property issues, to unfair trade practices in which Chinese companies might engage in the U.S. or other markets. Further, we have recently faced some serious challenges regarding the safety of Chinese imports. Let me begin with an overview.

Overview of U.S.-China Relations

Since China started down the path of reform some thirty years ago, it has enjoyed some of the highest rates of sustained economic growth the world has ever seen. We welcome China's move toward market-based economics.

Indeed, it has been the policy of the United States, across all administrations to engage China politically and economically as it has struggled to move toward market economics. In the 35 years since the signing of the Shanghai Communiqué, U.S. economic policies have had two main goals: to help China move to a rules-based system and to help China internationalize its economy. These policies culminated with China's accession to the WTO in 2001, which resulted in China's membership in the world's primary forum for economic engagement. China now has both the rights and responsibilities that come with membership in the international trading system.

The U.S. has also benefited from this policy. China is one of our fastest growing markets and is now our fourth largest export market. U.S. exports to China totaled $55 billion in 2006, up 32 percent from the previous year. To put this in perspective, U.S. exports to China were greater than U.S. exports to India, Brazil and France combined. According to industry surveys, U.S. companies in China are generally successful and report solid sales in the China market. And our companies and consumers derive benefits from imports from China as well.

At the same time, we must recognize that there are a range of trade and economic practices in China that most would consider unfair. For example, the non-market driven growth of China's steel industry risks creating global over supply, and China's efforts to legislate policies that protect significant segments of domestic industry at the expense of foreign competitors, as evidenced by the latest draft of China's Anti-Monopoly Law, foster an unlevel playing field in China.

At the Department of Commerce our China work falls into three general areas: tough-minded negotiations to achieve more access to markets; aggressive enforcement of our trade laws to fight illegal dumping and subsidies; and a strong commitment to trade promotion to help U.S. companies compete and win in the Chinese marketplace.

Let me provide a description of some of the things we are doing in each of these areas.

Commerce's Role in Trade Policy

The most important mechanism we have to promote policy change in China is through trade negotiations. We regularly consult with China on a range of trade policies, regulations, and practices in order to improve the business environment in China for our companies and for exported goods and services.

To achieve our objectives, we are engaging the Chinese through bilateral consultations, chiefly the Joint Commission on Commerce and Trade (JCCT), co-chaired by the Commerce Department and USTR, and the Strategic Economic Dialogue (SED), led by the Treasury Department.

Joint Commission on Commerce and Trade (JCCT)

For almost 25 years, the JCCT has served as a bilateral consultative mechanism to resolve specific trade concerns and promote commercial opportunities. Since 2004, the JCCT has met at an elevated level, with Secretary Gutierrez and U.S. Trade Representative Schwab now chairing the U.S. side and Vice Premier Wu Yi chairing the Chinese side. At the last JCCT in 2006, the U.S. and China reached agreement on a number of matters, such as: (1) eliminating some redundant regulatory requirements for medical device imports; (2) improving enforcement of intellectual property rights by requiring installation of legitimate operating systems software; (3) a deadline for China to commence formal negotiations to join the WTO's Government Procurement Agreement; and (4) reviewing export control cooperation. In addition, China announced that its State Council issued a notice requiring that all laws, regulations, and measures affecting trade be published in a single official journal. We expect to hold the 18th session of the JCCT in late fall in Beijing.

Chinese and U.S. officials meet in a number of JCCT Working Groups throughout the year to address issues such as tourism, IPR, high technology, subsidies and export controls. In addition, we continue to engage China on rising steel imports through a dialogue on steel.

Strategic Economic Dialogue (SED)

The U.S.-China Strategic Economic Dialogue (SED) provides an additional forum for advancing our trade agenda. The second meeting of the SED was held May 22–23 in Washington, and the third will be held in December in Beijing.

The SED is a mechanism for maintaining strong and mutually beneficial economic and trade relations between the United States and China. The Commerce Department works closely with Treasury, USTR, State and other agencies to promote long-term structural change. At the meeting in May, leaders from both countries agreed to liberalize air services rights, undertake further financial sector reforms, work to foster energy security, and take additional steps to protect the environment and strengthen the rule of law.

Commerce's Enforcement Role: Enforcing Trade Laws and Agreements

The second area in our approach to China, the focus of my responsibilities at Import Administration within the Department of Commerce, is aggressive enforcement of our trade laws to ensure a balanced playing field for American manufacturers, a task to which the Administration is fully committed. Commerce currently maintains 62 antidumping duty orders on imports from China, including consumer goods, steel products, agricultural products, seafood, and chemicals. These orders represent 27 percent of the total antidumping duty orders we currently have in effect globally and cover almost $6 billion in imports.

Earlier this year, Commerce preliminarily modified a 23-year-old government policy by applying the anti-subsidy law to China. In the countervailing duty investigation of coated free sheet paper from China, Commerce preliminarily determined that the current nature of China's economy does not create the obstacles to applying the anti-subsidy law that were present in the "Soviet-style economies" at issue when we originally developed our policy more than 20 years ago. China of 2007 is not the Soviet Bloc of 1984. Our preliminary determination reflects the view that we can and should measure and remedy subsidies in China when they exist. We will be issuing our final determination in October of this year.

Just as China has evolved, so should the range of tools available to make sure that China trades fairly. Indeed, I was just in China last week for an on-the-ground investigation of subsidies to China's paper industry. Additionally, my agency is now investigating subsidies to China's steel industry.

To further ensure that China lives up to its trade commitments, the U.S. also makes use of the WTO dispute resolution process. In January 2006, the U.S. warned China about the imminent filing of a WTO case challenging an antidumping order imposing duties on imports of kraft linerboard from the United States, and the Chinese side quickly rescinded that order. We now have four WTO cases against China. In 2006, the United States, Europe, and Canada brought a WTO dispute challenging China's discriminatory charges on imported auto parts. In February 2007, the United States filed a case challenging China's use of prohibited export and import substitution subsidies. In April 2007, we filed two more WTO cases against China—one raised a number of IP enforcement issues, and the other focused on market access restrictions affecting U.S. copyright-intensive products such as publications, and audio and video products. In addition, China remained on the Priority Watch List in USTR's Special 301 report and subject to Section 306 monitoring based on their record of IP protection.

Clearly, a fair and tough-minded approach to enforcement of our trade laws and agreements is a critical component of our engagement with China.

Commerce's Trade Promotion Role: Assisting U.S. Exporters in China

Beyond negotiations and our trade enforcement work, the Commerce Department's mission is to ensure that American companies can compete and win in the Chinese market. Our Commerce team in China constitutes our largest overseas presence, with a staff of 130. The China Team, supported by our China trade specialists in Washington and our export offices across the United States, work directly with companies, particularly small and medium-sized enterprises (SMEs), interested in exporting to China to develop market opportunities, facilitate business and solve problems.

Developing Market Opportunities: Activities in China

Through our Commercial Service, we assist U.S. companies in areas such as export counseling, customized market research, qualified international contacts and trade leads, match-making, and trade events.

- In response to a 2004 Congressional mandate, we have opened American Trading Centers in 14 key cities. The American Trading Centers initiative opens up large and growing, but underserved markets, helping U.S. firms compete for major local infrastructure projects and sell directly to Chinese importers. These Centers provide targeted market research; counseling; match-making with local Chinese buyers, importers, etc.; and representation at trade shows.
- The Commerce Gold Key Program helps U.S. companies find a buyer, partner, agent or distributor. In FY 2006, 182 companies participated in this program in China, up from 103 in 2005.
- In 2006, the China team recorded 719 export successes related to China, with a value of $3.1 billion, compared to 250 export successes in China, valued at $1.9 billion in 2001.
- In 2006, the Department participated in 37 major trade shows in China, compared with only four shows in 2004. Additionally, we supported more than 50 trade missions in China in 2006.

Business Outreach: Activities in the United States

Commerce manages a range of outreach programs across the United States: road shows, websites, webinars and a hotline. Through these programs, Commerce assists companies of all sizes to enter the China market and provides additional information on Federal resources and assistance.

- *China Business Information Center:* The China Business Information Center (CBIC) provides China-related information to enable U.S. exporters to promote products and services, understand Chinese laws and customs, obtain market research, and take steps to enter the Chinese market. Since its October 2004 launch, the CBIC has organized or participated in more than 213 outreach events in 41 states, reaching almost 13,600 business executives with information, advice and direction on exporting to China. The CBIC website attracts more than 1,400 visitors per day on average and has recorded more than 24 million hits.
- Commerce works with industry associations and local governments on a series of *Doing Business in China seminars* targeting SMEs around the country. In 2006, Commerce hosted 70 outreach events, attended by 5,250 participants.
- The Commerce *Advocacy Center* serves as a central U.S. Government (USG) point of contact through which U.S. companies can access government resources

and request USG advocacy in competing for international government tenders. To date in FY 2007, USG advocacy has already successfully assisted American companies in winning tenders in China worth about $4.4 billion, with more than $3.8 billion in U.S. export content.

- To assist U.S. companies (particularly SMEs) in protecting their intellectual property rights, Commerce has developed a wide range of services to provide up-to-date information on protecting and enforcing IPR at home and abroad, including information on registration, border enforcement, and criminal enforcement. A Commerce hotline, 1–866–999–HALT, allows U.S. exporters to submit requests for assistance.
- Commerce's China Office hosts free monthly webinars and gives presentations on China IPR issues to assist U.S. industry. More than 850 online participants have participated in the 13 webinar programs, with more than 3,000 visits to the archived programs. In 2006, our China Office and Office of Intellectual Property Rights experts gave presentations in cities across the United States providing guidance to SMEs on how to protect their IPR abroad. Further, from 2005 to the present, the United States Patent and Trademark Office (USPTO) has also been actively engaged in assisting U.S. companies on how to protect/enforce intellectual property rights through its China Road Shows, 2-day seminars, and workshops conducted throughout the U.S.
- ITA's Office of Intellectual Property Rights has recruited the expertise of the Patent and Trademark Office and the Small Business Administration to develop an online training program for SMEs to learn how to evaluate, protect, and enforce their intellectual property rights. The program will be offered online at *StopFakes.gov* free of charge, and is scheduled to be launched in September 2007.

Problem-Solving in China

When U.S. companies encounter problems in China, our China team is available to provide on-the-ground assistance. In addition to our trade specialists who cover a wide range of trade issues, the Commerce Department has experts dedicated to resolving IPR, subsidies, dumping, and export control issues. With IPR problems, Commerce has developed industry partnerships linking businesses with lawyers who have China expertise, and a program with the Chinese Government to ensure that specific IPR cases are passed to relevant Chinese agencies to be resolved.

- Commerce has posted two "*Intellectual Property (IP) Attaches*" at our Embassy in Beijing, and an additional IP attaché will be joining the Consulate in Guangzhou. These IPR attachés work with the Chinese government to ensure that China is living up to its IPR commitments and to assist American businesses in protecting their IPR in China. One of the key tools they use to help U.S. industry is the "*IPR Case Referral Mechanism*", where China's Ministry of Commerce serves as the point of contact for individual IPR cases raised by the United States. In addition, last year Commerce's China Office effectively handled IPR concerns raised by U.S. SMEs by partnering with industry associations on the China Advisory Program—offering U.S. businesses free IPR consultation with an attorney. Forty-seven companies have utilized the program since its inception. The success of this program has led to expanded advisory programs for SMEs doing business in Brazil, Russia, India, Egypt, and Thailand.
- Commerce has also posted two "*specialists in dumping and subsidies law*" at our embassy in Beijing to assist our Washington-based Trade Remedy Compliance Office, which specializes in China trade remedy cases.
- We have a Trade Facilitation Office at the U.S. Embassy in Beijing which assists companies with compliance and market access problems and hosts industry-specific IPR roundtables in China with U.S. companies based in China to discuss the protection and enforcement of IPR in China, and how the U.S. Government and the private sector can work cooperatively to address industry's specific IPR issues.
- Commerce's Bureau of Industry and Security (BIS) has an Export Control Officer posted in Beijing to conduct end-use visits and work with Chinese government and industry on export control issues. End-use visits help increase confidence that sensitive U.S. technology is used for legitimate purposes and therefore facilitates high tech trade.

Consumer Safety Issues

Finally, I would like to say a few words on the issue of the recent high profile alerts and recalls by the FDA, Consumer Products Safety Commission, and the National Highway Traffic Safety Administration (NHTSA) as a result of imports from China. Safety, of course, is of paramount importance to all of us. The Administration's response to unsafe—imports has been aggressive. HHS recently announced the creation of a food safety czar within FDA, the Administration is working constructively with the Chinese and will continue doing so in order to ensure the safety of all food, medicines and other products imported from China, and on July 18 President Bush issued an Executive Order establishing the Interagency Working Group on Import Safety, led by HHS Secretary Leavitt and including Secretary Gutierrez and other Cabinet Officials, to identify further steps we can take to enhance the safety of all imports into the United States.

Closing

The engagement I have mentioned constitutes a multi-pronged approach, designed to bring about positive changes in China's trade policies, regulations, and practices to level the playing field. This overall trade strategy is pursued by Commerce, USTR, State, Treasury, and many other U.S. agencies involved in U.S.-China trade relations. This integrated, mutually reinforcing strategy is the best way to ensure successful outcomes in U.S.-China trade relations.

A strong, healthy trade relationship is essential for the benefit of both our countries. We will continue to work to ensure that the Chinese Government provides market access for U.S. firms, and lives up to its international trade commitments. American companies, workers and farmers can compete with anyone in the world, given a level playing field, and we are committed to working with our Chinese counterparts to achieve this goal.

As China continues to reform its economy, we believe our approach will move China away from its reliance on industrial policies and subsidies and toward greater adherence to its international trade obligations and more progress on the path toward a market economy. After all, a China that is part of the international trade community and that is open and fair in its economic dealings, is very much in the interests of the United States.

Thank you, Mr. Chairman. I am happy to take any questions.

Senator DORGAN. Mr. Spooner, thank you very much.

You indicated that exports are booming, to use your term, to China. It is the case, isn't it, that imports are rising even faster in dollar terms than exports?

Mr. SPOONER. In dollar terms, yes, sir. In percentage terms, our exports are growing more quickly. But in dollar terms, imports are rising.

Senator DORGAN. If you have a very low amount of exports from the United States to China and double it, you can say we've doubled exports and they're booming, but it's not nearly as consequential as taking a look at the bilateral trade balance. The bilateral trade balance has mushroomed to a $130 plus billion deficit. Isn't that the case?

Mr. SPOONER. That is certainly true. And indeed, I firmly agree that it's our responsibility to level the playing field to the extent we possibly can.

Senator DORGAN. I raised the question, and so did Senator Sanders, about the bilateral automobile trade. We negotiated this under Republican administrations and Democratic administrations. You can put a blindfold on and not tell which administration is speaking on free trade issues. We negotiate deals, and let me describe the deal with automobiles. I said in my opening statement, we said to the Chinese: If and when you begin exporting automobiles, you can put them into our country at 2.5 percent tariff and you're welcome to charge a 25 percent tariff on U.S. cars we sell to China.

We did that with a country with whom we have a very large trade deficit. Is there any justification for that that you're aware of?

Mr. SPOONER. I think the response to that, Mr. Chairman, is that the WTO accession package with China or with any other country, as you know well—I used to work on the Hill—is about that thick [indicating] when it arrives up here, and it's a package involving not only automobile tariffs but thousands of tariff lines and all sorts of non-tariff commitments. And the administration before they, whatever administration it is, before they sign the deal makes the judgment that the package as a whole is fair to the United States, and Congress in its ultimate wisdom votes on the package itself.

Senator DORGAN. But the question, I'm just taking this as an example, and I could use many examples. But on bilateral automobile trade, the Chinese are ramping up an automobile export market. They're very aggressive, they're very anxious to move. My understanding is that Chrysler is going to introduce into this country an automobile called the Chery, made by a company called Chery, which is one letter away from "Chevy," which is interesting because General Motors itself took Chery to court, saying that they had stolen their production designs for that car. It was settled out of court and you can't determine what the settlement was because no one will say.

But nonetheless, we're apparently now going to get the product of Chery imported into this country, in terms which provide them a tariff that is one-tenth the tariff that we will meet when we try to export cars to China. I mean, I don't think there's anybody that can say, yes, that makes a lot of sense from the standpoint of all those workers, all those companies that are trying to produce U.S. automobiles.

Mr. SPOONER. I agree. Again, I think the only response I can give is that when we sign and then vote on the WTO accession package it involves every tariff line, not only automobile tariffs.

Senator DORGAN. Would you agree with this, that when we signed and allowed, gave the green light to China to join the WTO and reached a bilateral agreement, that at the time we reached our bilateral agreement our trade deficit was $83 billion a year with China and now it is $230 billion a year? Would you agree that's movement in the wrong direction?

Mr. SPOONER. Yes, although—that's certainly correct, of course, Mr. Chairman, although I would argue that it's not necessarily the Government's role to artificially manage trade. It's our role to make sure the playing field is level, that China is living up to its commitments and that we enforce our rights to the extent we can and negotiate better rights if our rights aren't good enough.

Maybe the trade deficit is indicative of—it's indicative of other things as well as trade enforcement. But it's our role as the Government to enforce our rights as thoroughly as we can.

Senator DORGAN. But if a bilateral trade agreement produces from $83 billion to $230 billion, it seems to me that there's something wrong.

Mr. SPOONER. Sure, but the trade agreement is there or China's WTO accession is there. It's a fact and, at least as an administrator of the law, the Commerce Department's role is to enforce our rights under that agreement as best we can.

Senator DORGAN. Do you think part of the reason we have this big trade deficit is because we have regulations in this country to protect the air and the water and won't allow somebody to put poisons in pet food and so on? Is this a regulatory problem?

Mr. SPOONER. To be honest, that's a little bit out of my lane because I handle trade. But on the flip side, I should probably opine that it's frankly free trade agreements that allow us to address labor and environmental issues in other countries. I know we have a vigorous debate over trade and environment provisions of FTAs, but right now we have no rights at the WTO or anywhere else to improve the environment in China, and should we engage China further on trade that might give us additional rights to exercise.

Senator DORGAN. On the issue of the environment and the rights of the workers, as you know, the administration has opposed by and large up until this point putting anything in with respect to those issues in trade agreements. The only trade agreement in which anything was included with respect to labor issues was the Jordan trade agreement, and we've had a hearing in this Committee about that. In fact, although Jordan has a provision which is good, that we've forced that in that one trade agreement, and this administration has opposed that ever since. In Jordan, we have testimony and pictures and eyewitnesses and descriptions of workers being brought in by the planeload to work in sweatshop conditions, paid pennies, in some cases paid nothing, nearly imprisoned and beaten, the most unbelievable circumstances you can imagine in sweatshops, bringing in workers from Sri Lanka, textiles from China, to produce sweat shop garments to be sold in our marketplace.

We're trying to shut all that down, but one of my great concerns about all of these trade agreements is there's no labor provision, there's no environmental provision in most cases.

Mr. SPOONER. I think that's a great point, Mr. Chairman. I believe all of our free trade agreements contain some labor provisions, although Jordan was very different than the other FTAs that we've negotiated since 2001. And stating the obvious, to say we have a vigorous debate over what those provisions should be and whether they're adequate in our FTAs.

But the Jordan example is probably a good one because it was our FTA with Jordan that enabled us to improve labor conditions in Jordan. There was an allegation that Jordan was violating the terms of our free trade agreement, but when those allegations came to light and we threatened to exercise our authority under the FTA Jordan supposedly has worked to clean up its act.

Another good example is probably in a parallel agreement we have with Cambodia that was negotiated back in 1998 that allowed Cambodia to ship more apparel to the United States, but sort of made the quotas or the amount of apparel contingent on labor conditions in Cambodia. I think it's folks' unanimous view that that trade agreement has significantly improved labor rights in Cambodia.

Of course, to a certain extent when we trade with other nations—and this is probably somewhat uncontroversial, but—when we trade with other nations, American companies bring their good labor practices to those other countries, and when business conditions improve labor conditions improve.

Senator DORGAN. Senator DeMint?

Senator DEMINT. Thank you, Mr. Chairman.

Thank you, Mr. Spooner. I understand—and I'm sure you're familiar with the Commerce Department study that showed, irrespective of labor costs, that the cost of doing business in America, the cost of regulation, litigation, and taxes, is over 20 percent more than our leading trading partners. There is a connection between the trade deficit if our products cost more.

Am I correct in my memory that the manufacturing output in America is at an all-time high?

Mr. SPOONER. Yes, sir, that is correct.

Senator DORGAN. That is true, and because of productivity the employment side of it is certainly not growing, but it is growing in other areas, because our unemployment rate is as low as it has been in many, many years.

I need to correct my colleague who was here earlier. He was trying to suggest that poverty is related to trade, when all the research shows that it's directly related to our failing government education system and the breakdown of our families.

I think on the food safety issue there have been many more poisonings in this country from American-made, such as spinach just a short while back. And the pet food that did come here came through Canada, and the toothpaste never got here. So layer after layer of regulation does not necessarily give us safety, and certainly we can show that safety in this country is as much suspect as it has been in China.

But Mr. Spooner, I want to direct one question to you because this trade deficit figure is used a lot and it actually misrepresents what happens. Some researchers at the University of California—if you could just reference this particular chart here. On just the Apple iPod, to find out where the pieces came from, where the costs came from, if you look at the iPod itself, the hard drive, which is about 25 percent of the cost, $75, was made in Japan. About $15 worth came from the U.S. of just parts itself; from other Asian countries, 20 percent; and the non-hardware, which is a lot of the marketing research and development, most of that was done in the United States.

So you've got a $299 Apple iPod. At the very bottom here, this little yellow sliver that you can hardly see says two dollars worth of the components of that Apple iPod were made in China. Yet the product arrived here as a Chinese product and it adds $150 to our trade deficit with China.

Now, what I don't understand is why the Commerce Department doesn't update the way it collects its information and reports it, because clearly this is not a $150 trade deficit with China. But yet we're showing that. And we're compounding the charts we're showing here year after year when a lot of assembly is done in China, but we actually have more American productivity in this iPod than China does. Yet it's a trade deficit.

Now, can you explain why the Commerce Department hasn't given us better information?

Mr. SPOONER. Boy. Frankly, I can't. But I think you raise a good point and I'll go back and try to see what we can do to improve our data if it needs improving.

But I know what you say is true. You often hear that trade has become the final assembly point for inputs that are made throughout Asia and sometimes from our own country, and that when the assembled product enters the United States from China the total value of that product is accounted for in the trade deficit, even though some of the production may have occurred in Malaysia or even here.

But just to be frank, Senator DeMint, I should go back and talk to our statistical folks to see how we can improve that if possible.

Senator DEMINT. Well, it would be very important, because, as you know, economies are interwoven increasingly, and I can't go into a plant in South Carolina that is not making things from parts from all over the world. Many times they come from another part of the world. Actually, one of our fastest growing export countries is China, but we're exporting all over the world material that came in from China. And we've got to be real careful as a Congress when we start saying we're going to penalize the currency, we're going to add 20 cents or 30 cents or whatever we're talking about, which, first of all—do you happen to remember the figure of how much each American family saves each year from less expensive imports?

Mr. SPOONER. I believe it's—although I'd have to verify this number, sir, I believe it's $3,000 a year according to the——

Senator DEMINT. That's the figure that I remember. So it's more complicated than just socking it to the Chinese by adding a tariff that's going to affect American manufacturing as much or more than Chinese manufacturing, and that will likely add to the cost of living to American families.

So while the pursuit here I think is good, and I have questions about some trade agreements as you do and certainly the enforcement, which I don't think our government has been as aggressive on enforcing as we should and hopefully we can continue to improve, but there's more here than meets the eye and there's a lot we can do as a Nation to reduce that deficit and improve the quality of life of the American worker.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Brown?

Senator BROWN. I will be brief. I will add one thing to Senator DeMint's comments about products maybe coming from other Asian countries through China. It counts against the Chinese trade deficit. Products sometimes assembled in China or partially assembled where those components then go to Jordan and then are sent to the United States counts against the Jordan bilateral trade deficit. So I think it can cut a little bit both ways there.

Just a question, and I'm really looking for ideas. I look at what's happened with consumer products and food products coming from China. We understand—and maybe Senator DeMint thinks their regulatory system is better for the public at large than ours. I can't really tell, reading between the lines of his comments. But putting that aside, how big a concern is it that this wide open trading system, where we've actually cut the number of FDA inspectors from 30-some hundred to 20-some hundred over the Bush years as we import significantly more fruits and vegetables, as you can see in the supermarkets in February and March in northern states like mine—how big a problem is that and what should we do about that?

Is increasing the number of inspectors enough, or should we even bother doing that? Is that going to cost too much, that the President might veto the FDA legislation, the appropriations? What should we do so we can say to our families in Shelby, Ohio, and Hamilton, Ohio, that the food you buy and the toys you get for your kids are safe?

Mr. SPOONER. That's a great question, Mr. Senator. Indeed, I should say as a father of a 2 year old and a 3 year old who had some Thomas the Trains at home, I get an earful from my wife about the importance of product——

Senator BROWN. You should listen to her.

[Laughter.]

Mr. SPOONER. But I can say it is a tremendous concern to the administration. That's why the President assembled a panel of 17 different Federal agencies that now are responsible in some way for food and product safety together and directed them to report to him within 60 days about—first we're supposed to assess what each agency does, whether there's overlap, whether we can do things better, and to report back in 60 days on how we can improve.

But I can tell you—I frankly have attended initial meetings of this group—that it is a tremendous concern.

Senator BROWN. And they are considering sort of bilateral trade issues, not just inspections at the border?

Mr. SPOONER. Yes.

Senator BROWN. Thank you.

Senator DORGAN. Mr. Spooner, thank you very much for being with us. Are you able to stay for a bit?

Mr. SPOONER. Yes, sir.

Senator DORGAN. If you're able to stay, I appreciate it in the event we have a chance to ask further questions.

We will ask the other four witnesses to testify. We thank you, Mr. Spooner, for being here to represent the Commerce Department. Mr. Hoffa is President of the International Teamsters. Mr. Hoffa, thank you for joining us. If you would pull the microphone close, and your entire statement will be made part of the record and we would ask you to summarize. Thank you very much.

STATEMENT OF JAMES P. HOFFA, GENERAL PRESIDENT, INTERNATIONAL BROTHERHOOD OF TEAMSTERS

Mr. HOFFA. Well, thank you, Chairman Dorgan and Ranking Member DeMint and members of the Subcommittee. Thank you for inviting me to testify today on behalf of the Teamsters and its 1.4 million members.

Ideally, trade and globalization policies should be used as a tool to advance the priorities of the American people, American foreign policy and our national safety interests. In reality, the U.S. trade policies have achieved exactly the opposite effect, especially with regard to trade with China.

Recently I visited China. I went to Hong Kong, Shanghai, and Beijing. And while I don't hold myself out as an expert, I saw a lot of things there that really make you reflect on what our relationships are with that country. My clearest impression with regard to China is that their number one priority is economic progress, building up their nation. That's number one and the people basically come second.

We visited the Shanghai deep water port and container terminal, which by the way is brand new. It's a brand new terminal that's the second largest terminal in the world, and it was built within a short period of time. The port management and union members that welcomed us very openly said that they had set a world production record that day because they knew we were coming, and it was a record that was set that was unbelievable with regard to what we can do here in the United States. It's amazing what you can do in a communist country.

We were briefed on a large scale about what they're doing in their country with regard to the projects they're doing, massive projects. They're building the world's largest dam. They're building bridges and tunnels that would be in the *National Geographic* if they were done here. They're building railroads. They're doing amazing things in Beijing and Shanghai.

When you go to their downtowns, it's like going to a construction site. There are cranes everywhere and there is a bustle everywhere. So we really see what's going on there.

We were supposed to see a dramatic improvement in workers' rights in China according to those who are supporters of PNTR. Unfortunately, that's not what has been the case. In fact, increased trade and investment have only promoted the continuation of workers' rights violations and the rising unrest which we see throughout China.

We had extensive talks with the ACFTU, which is the All China Federation of Trade Unions, and we talked about what they're doing there as a trade union. They talked about the contract labor law, which is a minor improvement to try and basically raise the standard of living in that country. I was shocked to find out and extremely disappointed that American companies, the General Motors and all the big companies that have moved over there, the Motorolas, the Microsofts, were lobbying very hard against that law to dilute it so that the workers wouldn't have any rights, the few small rights that they have over there. U.S. multinational corporations have resisted these changes and have been successful in watering down many of the reforms.

An important action that Congress can immediately take to remove any incentive a country may have to manufacture and import goods under terrible working conditions is Senate Bill 367, the Decent Working Conditions and Fair Competition Act, introduced by Senator Dorgan. Also, we must demand that any future administration accept section 301 petitions on labor rights in China. As you know, this administration has routinely rejected section 301 petitions. If China does not comply with basic internationally recognized workers' rights, the U.S. should pursue remedies against China. It's as simple as that.

Today we see much in the paper about what's going on with regard to workers. In 2000 when China PNTR passed, I said then and I say it now: China PNTR has nothing to do with the access of U.S. businesses to sell goods in China and everything else to do with U.S. companies moving out of the United States and moving over to China and then bringing their products back. It's just like NAFTA.

Almost 60 percent of China's exports come out of foreign investment firms. In other words, there are American companies going over there setting up plants, and they're the ones that are doing most of the work, 60 percent. Yet we have few laws on the books that provide—we have laws on the books that actually provide tax preferences for companies to move offshore. In other words, we make it so they can make it better off if we encourage people to leave. That must be stopped immediately. That doesn't make any sense for America.

Proponents of China's entry into the WTO claimed that it would create jobs in the United States, increase U.S. exports, and improve the trade deficit with China. What have we seen? The exact opposite. In fact, we have seen the closure of thousands of U.S. factories and the disruption of our manufacturing base here in the United States.

The U.S. trade deficit with China has increased from $50 billion in 1997 to $235 billion in 2006, an increase of $185 billion. This dramatic increase in the trade deficit with China has displaced production that could have supported more than 2 million U.S. jobs.

We must really start enforcing our trade agreements. The problem we have with China is not only that we have a one-way trade relationship, but there is a disregard of the rule of law and international commitments that China has made. And on our part, we're just as much at fault because we haven't enforced what is in WTO and in trade agreements. Since China entered the WTO it has consistently refused to grant access to its markets and has done so in a way that anybody else would call cheating.

The U.S. Government has allowed the cheating to occur, but never utilized the legal action we have available to us to address illegal subsidies, dumping, dangerous imports, and currency manipulation. The U.S. Government should address China's refusal to fully and faithfully implement its WTO commitments. Also, before any additional preferences are given to China or any other country in future WTO or Doha negotiations, that country must live up to and implement the very promises they made in the trade agreement.

We've all heard about the manipulation of the Chinese currency. Foreign ownership of U.S. debt has reached more than $3 trillion, a dangerous level that is another potential threat to our very national security. China alone holds $353 billion of U.S. Treasury securities. Conceivably, they could cash out any time and cause a financial crisis in this country.

Unfortunately, some have used that very argument to say we shouldn't enforce our laws because we're at their mercy. I say we should enforce that and make sure there's fair trade. Our indebtedness to China should not delay efforts to offset trade imbalances aggravated by the exchange rate misalignment.

In essence, the China undervalued yuan is effectively a 40 percent tax on U.S. agriculture. There basically has been a misalignment of currencies and the 40 percent difference between their currency and ours gives a subsidy to their exports to our market.

The Teamsters believe it is imperative that Congress pass the Stabenow-Bunning-Bayh-Snowe bill, which is Senate Bill 796, and its counterpart in the House, the Ryan-Hunter bill, H.R. 782. These bills recognize that undervalued exchange rate misalignment by China or any other country is prohibited under U.S. and international law and we can ensure that action will be taken if these things happen.

The biggest things in the headlines recently have been unsafe trade, unsafe pet food, poisonous toothpaste, contaminated catfish, defective tires, and we mentioned Thomas the Train with lead paint on it. These things have really risen to the level now that everybody's talking about them. Why aren't we inspecting what we have now? Senator Brown said how we've cut the number of inspectors. Only 1 percent of the products coming into this country from China, whether it's food or anything else, is inspected, which means 99 percent is not inspected.

We do, we do need increased inspections. We need to have more consumer activity with regard to watching what is coming in here and are we being poisoned by the very things we're buying. Congress needs to pass legislation by Senator Brown and Senator Durbin that gives the FDA the authority to approve or disapprove of countries eligible to import into this country.

In conclusion, it's not that the Teamsters Union is against trade, but we want fair trade. We want trade that is one that's fair to everybody, that creates jobs in this country and does not promote jobs leaving this country. When that is done, the American labor movement will be for fair trade.

Thank you.

[The prepared statement of Mr. Hoffa follows:]

PREPARED STATEMENT OF JAMES P. HOFFA, GENERAL PRESIDENT,
INTERNATIONAL BROTHERHOOD OF TEAMSTERS

Chairman Dorgan, Ranking Member DeMint, and Members of the Subcommittee, thank you for inviting me to testify today on behalf of the 1.4 million union members of the International Brotherhood of Teamsters on this important issue. Under my leadership at the International Brotherhood of Teamsters, the issue of trade and how it impacts workers, families, and our national security has always been a top priority. Our workers have seen directly the impact that our trade policies, especially with China, have had on them. This hearing is especially timely, not only because I have recently returned from my first trip to China, but also in light of all of the alarming news recently regarding Chinese imports, and the fact that China legislation is expected to be considered soon.

Ideally, trade and globalization policies should be used as a tool to advance the priorities of the American people, the worker, and American foreign policy and national security interests. In reality, U.S. trade policies have not achieved this; in fact, our trade policies have achieved the opposite effect in all areas, especially with respect to trade with China.

Visit to China

My fact-finding visit to China in May included stops in Hong Kong, Shanghai and Beijing. Our delegation included Teamster Vice Presidents Chuck Mack from Oakland, California and John Coli from Chicago as well as Andy Stern of SEIU, Arturo Rodriguez from the United Farm Workers, Edgar Romney from UNITEHERE, and Anna Burger and Greg Tarpinian from Change to Win. I went because I wanted to learn first-hand about challenges that working people face in China. I wanted to know more about working conditions, pay and benefits, and worker organizations.

I know that corporations operating globally are profiting handsomely from expanded operations in China, but what about workers?

China is now a global economic powerhouse and I wanted to take a fresh look at what that means for Teamsters. I believe that a constructive China policy can unite workers in the United States, China and around the world, all of whom have an interest in stopping the race to the bottom. Many of us in the labor movement are seeking alternatives to the flawed "free trade vs. protectionism" debate seeking new ideas about how the U.S. should respond to globalization.

We met with the All China Federation of Trade Unions—ACFTU, the only legally sanctioned trade union body in China. We also met with union leaders and academics that are critical of that union and of the current government. We met with advocacy organizations that are documenting the poor working conditions of millions of Chinese workers in the special economic zones that are set up on China's east coast. We met with Teamster employers with subsidiaries in China, and with the American Chamber of Commerce in Beijing. We visited key infrastructure facilities including Shanghai's new deep water port and air hub distribution facilities.

We were only there for 10 days so by no means do I claim to be any sort of expert, but I came away from the trip with some very clear impressions.

My clearest impression is that economic growth is the top priority for the Chinese government.

We visited the Yangshan Deepwater Port and Container Terminal. A twenty-mile causeway from Shanghai leads to the port which was inaugurated in 2005 and is now by some measures the second largest port in the world. The Port management and union welcomed us by advising that they had set a world production record the prior evening in our honor. Our questions about what happened to the residents of the fishing village that formerly occupied the island were simply not understood. Any rights of those residents meant nothing in the push for economic growth.

We were briefed on large-scale highway projects, bridges, tunnels, electric generation plants, dams, and railways. Parts of Beijing seemed like one big construction project as hotels and sports complexes were being erected in preparation for the 2008 Olympics. But when we asked about the residents whose homes and livelihoods were displaced by these projects we were given vague, unconvincing answers about new housing projects.

I had an image of folks all wearing the same design and color clothes and riding bicycles. This was not the reality in the cities I visited. I sat in heavy traffic with lots of late model cars. There are clearly a number of Chinese benefiting from the growth in trade. My impression was that while immigrants from the countryside to large cities and manufacturing areas along the east coast of China were living somewhat better than they did on the farm, Chinese workers linked to the globalized export economy are not getting their fair share of the wealth being generated.

While we met with some workers whose wages and benefits were steadily improving, we also spoke to workers earning well below the minimum wage while working sixty and more hours a week with no holidays or vacations; all violations of local labor laws. The health care and pension systems do not afford basic benefits to the vast majority of workers and make it very difficult for workers to plan for the future.

China will overtake Germany as the world's third largest economy by the end of this year, this growth was a great source of pride for the government and union officials we met. We challenged our Chinese union counterparts to seek improvements in the wages and benefits for their members so prosperity is shared and growth can be sustained.

China is currently not building a middle class capable of sustaining economic growth through a domestic consumer market. China is setting the global norm for working standards around the world; my conclusion is that those standards are much too low for workers in the U.S. and workers in China. We plan to work with all of the worker advocates we met to improve those standards.

We learned about very weak enforcement of laws and regulations and that corruption in business and government are rampant and getting worse. These conditions make it even harder for workers to organize and demand their fair share in economic development.

Labor Law Reforms in China

China's repression of labor rights has suppressed wages, thus subsidizing its exports and making them artificially cheap. This Administration has consistently failed to raise the issue of workers' rights violations in China. Worker's rights is just as much an economic issue as currency manipulation or illegal subsidies. This was also an area that we were supposed to see drastic improvement according to PNTR supporters—workers rights and human rights would be improved with China's accession to the WTO. Unfortunately, this has not been the case. In fact, increased trade and investment have only promoted the continuation of workers' rights violations, and rising worker unrest.

In China, we had extensive discussions regarding the recently approved reforms to the Contract Labor Law. These modest reforms were proposed to address the widespread exploitation of workers who are often cheated out of wages due them. The reforms are intended to enforce employment contracts, protect temporary workers, limit employer rights to fire at will, enhance severance pay and require transparent workplace rules.

I was extremely disappointed to learn that U.S. companies actively opposed these modest changes. All of the corporate talk about raising standards through investing in China is hollow rhetoric. Instead of using their influence as a force for democracy and social justice, U.S. companies are pursuing the low road. There was a time when U.S. multinational companies joined with the labor movement to actively oppose apartheid in South Africa and undermine military dictatorships in Latin America. Worker organizing and unions were encouraged at their facilities, unions were considered to be incubators for building democracy.

And now there is a need, a movement to make drastic changes in China's contract labor laws and yet U.S. multinational corporations have resisted these reforms and have even been successful in weakening the modest reforms. Some have even threatened to move to Vietnam, another country that Congress recently granted PNTR status. Global Labor Strategies has an excellent report on this issue titled "Undue Influence: Corporations Gain Ground in Battle over China's New Labor Law". I urge Senators to read the report.

An important action that Congress can immediately take to remove any incentive a country, including China, may have to manufacture and import goods made under terrible working conditions, is to pass S. 367, the Decent Working Conditions and Fair Competition Act, introduced by Senator Dorgan. This legislation bans the importation or sale of products made in factories under sweatshop conditions. Such "sweatshop conditions" include gross violations of the wages, hours, health and safety laws of the country where the labor is performed.

Also, we must demand that any future Administration accepts a Section 301 petition on labor rights in China. If China does not comply with basic internationally recognized worker's rights, the U.S. should pursue remedies against China. It is as simple as that, however this Administration refuses to act.

Current U.S. Trade Policies with China Hurts U.S. Workers

While China's need for legal reform has hurt U.S. jobs, that is only a piece of the challenges we face with respect to trade with China and trade overall. Our nation's flawed trade policies contribute to the anxiety and uncertainty many Americans feel about their jobs, their future, and even their children's future.

The public has lost confidence in our trade policies. U.S. trade policies lately seem to be more about the number of trade agreements signed rather than the results they achieve.

Sound trade policy means job creation and strong communities. It impacts whether or not we have an industrial base that can supply the materials needed to defend our Nation or whether we need to depend on other countries to do so for us; it impacts whether our communities have a good public school for our children or one that is struggling and in desperate need of basic resources because the town's factory has shut down and moved offshore to China taking with it the community's tax base; it impacts whether the future jobs of this country will be technology based or burger flipping based.

Mostly as a result of our trade policies, especially with China, we have lost more than 3 million manufacturing jobs since 2000. One in six manufacturing jobs has disappeared. This poses a serious threat, not just to the many families and communities who have been crushed as a result of this loss, but also our research and development capacity as a country. We are losing our capability to supply our military troops with uniforms, ammunition, and other essential items. If this trend continues, we will be completely dependent on other countries to provide everything to us. Our manufacturing loss is, in fact, a matter of national security. We are seeing first hand the limitations that our energy dependence has created with respect to our foreign policy and national security—we should not continue to follow down the same path of dependence and depend on China and others to supply us with all of our defense, food, and manufacturing needs.

In 2000 when China PNTR passed, I said it then and I say it now—China PNTR has nothing to do with access for our U.S. businesses to sell goods to China, and everything to do with moving U.S. companies and jobs out of the U.S. and into China in order to take advantage of workers in China and lax labor laws in China.

It has always been about investment there, no matter what the consequences brought upon our workers. The crisis we face now is what I and the Chairman knew would occur back in 2000 during the China PNTR debate.

Almost 60 percent of China's exports come out of foreign-invested firms, not Chinese firms. And yet we have laws on the books that provide tax preferences for companies to move offshore. These preferences must be eliminated.

China's entry into the WTO was touted as a mechanism to bring it into compliance with an enforceable, rules-based regime, which would require that it open its markets to imports from the U.S. and other nations. However the WTO and China's entrance to the WTO failed to include the necessary protections to improve or even maintain labor or environmental standards, which have resulted in an unfair playing field favoring large multinationals against domestic workers. Proponents of China's entry into the WTO, just like proponents of every Free Trade Agreement from CAFTA to the pending Peru and Panama FTAs have claimed that it would create jobs in the Unites States, increase U.S. exports, and improve the trade deficit with China. We have seen only the opposite occur. In fact, we have seen the global race-to-the-bottom accelerate forcing the closure of thousands of U.S. factories, and the decimation of our manufacturing base in the U.S.

The U.S. trade deficit with China has increased from $50 billion in 1997 to $235 billion in 2006, an increase of $185 billion. Between 1997 and 2001, before China's entry into the WTO, the deficit increased $9 billion per year on average. Between 2001 and 2006, after China entered the WTO, the deficit increased $38 billion per year on average.

According to the Economic Policy Institute, growth in trade deficits with China has reduced demand for goods produced in every region of the United States and has led to job displacement. The dramatic increase in the trade deficit with China between 1997 and 2006 has displaced production that could have supported 2,166,000 U.S. jobs. More than 1.8 million of these jobs have been lost since China entered the WTO in 2001.

The U.S. Must Enforce and Strengthen Our Trade Laws

The problem we have with China is not only that we have a one-way trade relationship, but also there is a disregard of the rule of law and international commitments that have been made, and a lack of enforcement on our part, all of which have been devastating to workers.

China provides significant subsidies to its companies to give them an advantage over all competitors which prevents our businesses from selling their products to China and floods our markets with their products. The U.S. Government must use existing trade enforcement rules aggressively and apply the remedies. We have failed to do this.

When China entered the WTO it agreed to conditions, but it has consistently refused to grant access to its markets that we provide to it, and has done so in a way that one would call cheating. But the U.S. Government is also guilty because it has allowed the cheating to occur by never utilizing the legal actions we have available to address illegal subsidies, dumping, dangerous imports, and currency manipulation.

The U.S. Government should be bringing more cases to address China's refusal to fully and faithfully implement its WTO commitments. Also, before any additional preferences are given to China or any other country in future WTO or Doha negotiations, countries must live up to and implement their existing promises.

China Currency

Foreign ownership of U.S. debt has reached more than $3 trillion, a dangerous level that is another potential threat to our national security. China alone holds $353.6 billion of U.S. Treasury securities. Conceivably, it could cash out anytime and leave us in a financial crisis. Unfortunately, some have used this as a reason to not enforce existing trade laws, specifically China's undervaluing of its currency. Our indebtedness to China should not delay efforts to offset trade imbalances aggravated by exchange-rate misalignment of the undervalued yuan. This enables Chinese exporters to gain up to a 40 percent price advantage over their competitors in the U.S. domestic industry. In essence, China's undervalued yuan is effectively a 40 percent tax on all U.S. agriculture and manufacturing exports and a 40 percent subsidy for China's exports to our market.

The reason for inaction is not that we do not have rules in place. We do have statutory and regulatory authority to address this problem. The World Trade Organization (WTO) and the International Monetary Fund (IMF) also have the rules in place to prevent countries from gaining an unfair advantage through exchange rate action. Yet our own government is not willing to implement the necessary provisions of the law to protect our workers and our manufacturing sector because they do not want to offend or upset China. This Administration has yet to even identify China's currency manipulation as a problem.

The President rejected recommendations from the U.S. International Trade Commission (USITC) under Section 421 of the Trade Act to grant import relief to U.S. industries facing market disruption from Chinese imports. As you are well aware, Section 421 of the Trade Act of 1974 was added to U.S. trade law during the China PNTR debate in order to ensure protection to U.S. industries in the case of surging imports. Specifically, Section 421 allows U.S. domestic industries to obtain relief should an investigation by the USITC finds that Chinese products are imported into the U.S. in such increased quantities as to cause a market disruption.

Recently, the Administration has rejected for the third time since 2003 a Section 301 petition by lawmakers demanding action by the Administration against China for subsidizing its exports by keeping its currency exchange rate artificially low which is in violation of international trade laws. As you are well aware, Section 301 of the Trade Act of 1974 allows the Office of the U.S. Trade Representative to initiate investigations of other countries' trade practices and impose sanctions for discriminatory behavior.

The USTR and the Department of Treasury continue to tell us that instead of acting to address China's currency manipulation, diplomacy mechanisms need to be used to address this concern. Diplomacy has obviously not worked. Congressional action is needed in order to ensure that change occurs.

The Teamsters are a member of the China Currency Coalition. We believe that it is imperative that Congress pass the Stabenow-Bunning-Bayh-Snowe bill, S. 796, and its counterpart in the House, the Ryan-Hunter bill, H.R. 782. These bills recognize that undervalued exchange-rate misalignment by China or any other country is a countervailable prohibited export subsidy under U.S. and international law, and ensures that finally action will be taken. The bill does the following:

- Recognizes currency manipulation as a government subsidy and allows a U.S. industry to use the anti-subsidy (counterveiling duty) law to seek relief from the injury caused by imports that benefit from a subsidy in the form of foreign exchange-rate misalignment. This is important because an undervalued currency allows foreign producers to price their products more cheaply than would be the case if the currency were properly valued. This applies equally to any country, whether a market or non-market economy, whose exchange-rate is found to be unfairly aligned.
- Clarifies that China's exchange-rate misalignment is a condition to be considered under Section 421 of the Trade Act of 1974. This holds China accountable to its market-disruption agreements made as a condition to its accession into the WTO in 2001.
- Protects our national security and defense industrial base by prohibiting the Department of Defense procurement of Chinese imports that compete with our domestic defense industrial base if China's currency misalignment is determined to be contributing to the disruption of the U.S. industry that manufactures those products.
- Requires the Secretary of the Treasury to analyze semi-annually whether there is a fundamental misalignment or exchange-rate manipulation by any trading partner, and bars the Administration from supporting increased voting rights in international financial institution such as the IMF for such violators.
- Strengthens the definition of misalignment in order to make it tougher for the Treasury to avoid giving that label to China's actions. This is critical in light of the fact that the Treasury Department recently admitted that there exists "heavy foreign exchange market intervention by China's central bank to manage the currency." Yet Treasury still refuses to officially identify China as a currency manipulator, despite this evidence that the Chinese government is continuing to undervalue its exchange rate against the U.S. dollar. They fail to call it as they see it and this provision ensures that this will no longer be the case.

I understand that the House Ways and Means Committee plans to introduce legislation and act on this issue in September. It should be the Ryan-Hunter bill or at the minimum consist of all of the essential provisions I have just listed. I am also pleased at the willingness of both the Senate Banking and Senate Finance Committees to each act on a currency bill. While both the Senate Finance and Senate Banking bills are not perfect, they take a step in the right direction to ensure action on currency manipulation bilaterally, at the IMF, and the World Bank. However, we need to ensure that the President cannot just avoid taking action on currency manipulation by creating loopholes that could potentially leave us in the same bind we are in now, where the Administration just does not act which is a potential problem in the Baucus-Grassley bill. Also, both bills at the moment do not recognize currency manipulation as a countervailing duty or subsidy which is important in addition to using an anti-dumping remedy.

I am pleased to see that action on currency is imminent. It is critical that whatever passes and finally becomes law is strong, real, and not an attempt to placate our concerns or put a temporary meaningless band-aid on a gaping wound—there is just too much at stake. Ensuring that this issue is finally acted upon can make the difference between having one's job disappear to China; the difference of having health insurance provided for one's family, and quite frankly about having an economically stable middle class.

Food and Product Import Crisis

Food imports constitute a growing share of what Americans eat and what we see on the shelves of our grocery stores. I care about this issue as a consumer, and as a President of a union that has food processing workers and farmworkers.

Food imports are more than four times greater today than what they were in 1996. Our Food and Drug Administration inspects less than 1 percent of imports. That means that 99 percent of our imports are entering our Nation unmonitored. This is especially troublesome when the bottom-line is put ahead of safety.

Senators on the Committee have heard the stories.

- Family pets have died from pet food containing wheat gluten that contained melamine.
- Concentrations of carbon monoxide are found in seafood imports coming in from Asia. Carbon monoxide treatment makes seafood appear fresh, regardless of its condition. Residues of antibiotics have also been found in seafood imports from China. For now, the Food and Drug Administration has acted and banned the imports of shrimp, catfish, and other seafood from China.
- Poisoned toothpaste from China, laced with diethylene glycol which is a chemical most often found in antifreeze and was substituted for the more expensive ingredient glycerin, has been imported into the U.S. I find it especially troublesome that China has stated that in small doses diethylene glycol is harmless, especially in light of the fact that cough syrup laced with diethylene glycol from China killed 100 people in Panama last year.
- And its not just hazardous food and toothpaste being imported—Thomas the Tank engines made in China have been recalled for using lead paint.
- As many as one million defective Chinese tires were sold in the U.S.

China has taken extreme and shocking action recently by executing its former head of its Food and Drug agency, Zheng Xiaoyu, as a response to this crisis. This is by no means consoling or the end to our troubles.

It is up to us to take responsibility and act thoroughly and quickly. The U.S. Government has not done enough to keep dangerous Chinese products out of the U.S.

Products manufactured in China have so far accounted for more than 60 percent of the Federal Consumer Product Safety Commission's 178 recalls so far in 2007. Congress needs to pass legislation by Senator Brown and Senator Durbin that gives the FDA the authority to approve or disapprove of countries eligible to import into the U.S.

We need to re-examine and make changes to our country-of-origin rules. For example, the Netherlands is the principal source of wheat gluten imports, but most of it initially comes in from China—actually over 80 percent of wheat gluten in the world comes from China. The bags of wheat gluten can simply state that the supplier was in Amsterdam-Holland for example. Since food processors are not required to inform consumers of the origin of its ingredients, it is especially difficult for Americans to know where exactly the ingredients were produced and to seek damages from companies that sell products whose ingredients have harmed. And in cases where they do, the protections are not in place to ensure consumer safety. This brings me back to the tire case. When the National Highway Traffic Safety Administration told the importer of defective tires that they must recall the tires, the company declared bankruptcy. When U.S. distributors rely on cheap imports to then sell back to U.S. consumers, they should be bonded to ensure that our U.S. consumers are protected.

We need more comprehensive food and ingredient labeling on products. Furthermore, the final purchasers of pet foods, meat, fish, and all consumer goods quite frankly, should be provided with the correct source of the goods. The FDA should implement new rules that require all food, vitamins, and other consumer products to list out the origin of all ingredients that come from outside the United States.

I was pleased to see that late last week the 2002 law requiring country-of-origin labeling for meat might finally be implemented. Animals born, raised, and slaughtered in the United States will be labeled "Product of the U.S." The 2002 Farm bill also requires country-of-origin labeling for fresh fruits and vegetables—hopefully this too will finally become a reality.

Only a minimal fraction of the 25,000 daily food shipments are ever tested by a government laboratory. We need to ensure that shipments of food and consumer products and ingredients are more readily tested, which is currently not the case.

The U.S. Government has a responsibility to its people to ensure that the safety and health of its families are not threatened by contaminated and sub-standard bad food and product imports. The U.S. Government has a responsibility that China's development does not come at the expense of America's domestic workforce, and national security. I hope to see immediate action taken to reflect this.

Conclusion

While the Chinese government may disagree, I believe that our current trade relationship with China is not just bad for the U.S. and our workers, but also bad for China. China has become dependent on the U.S. consumer market for employment, has suppressed the purchasing power of its own middle class with a weak currency, and have held hundreds of billions of hard-currency reserves in low yielding, risky assets, instead of investing them in public goods.

Unfortunately, the reality is that many of the U.S. jobs that have been lost are not coming back. But addressing all of the concerns that I have discussed and implementing actual reforms in China could help create new jobs in the U.S.

It is not that the Teamsters Union or the American people are against trade, its that the our major trading partners are not abiding by the rules of trade, and we are not requiring them to either. Once we finally see the field leveled, the right rules in place and enforced, and actual good-paying jobs created, that will be a win-win for U.S. workers and families. You can be guaranteed that the American people will support expanded trade, but until this happens you will continue to sense the unease that currently exists and the strong opposition that we put forth when more FTAs are passed.

Congress must take bold steps and big initiatives to address this current globalization crisis. Mr. Chairman, the title of your book comes to mind with what our current trade policies are about—"Take this job and Ship it—How Corporate Greed and Brain-Dead Politics Are Selling Out America." U.S. families can no longer afford to continue down this path of "Shipping jobs" and "Brain-Dead Politics." We can no longer allow our trade deficit with China to continue to skyrocket; we can no longer allow rules to be broken, or fool ourselves that our current trade policies will create jobs here at home when they are just about investing abroad. Congress is actually set to pass two more Free Trade Agreements with Peru and Panama using more or less the same model that has been used. Yes, the labor chapter is improved and that is a great and significant step, but that will not ensure the creation of U.S. jobs, and certainly will not stem the loss of them.

It is China's right as a nation to develop and gain economically, but it is our right and duty as a nation to ensure that if we are to continue to have expanded trade with China to the extent that we do, we must enforce our trade laws and implement new rules and protections necessary for our own economic development. We need to demand access to their markets because so far, it is just one-way trade. I like the Chinese and wish them well, but I love and fight for U.S. workers and it is time that this Administration and all of us in this room take control of our globalization policies to ensure that our workers benefit and our families are kept safe.

Thank you again for the opportunity to testify. I look forward to your questions and comments.

Senator DORGAN. President Hoffa, thank you very much for your testimony. We appreciate your being here.

Next we will hear from Brian O'Shaughnessy, the Chairman and CEO and President of Revere Copper Products in Rome, New York. Mr. O'Shaughnessy, you may proceed.

STATEMENT OF M. BRIAN O'SHAUGHNESSY, CHAIRMAN, CEO, AND PRESIDENT, REVERE COPPER PRODUCTS, INC.

Mr. O'SHAUGHNESSY. Good afternoon, Chairman Dorgan and Ranking Member Senator DeMint. My company is Revere Copper

Products. We were founded in 1801 by Paul Revere and believe we're the oldest manufacturing company in the USA. Our modern copper rolling mill is in Rome, New York, and produces copper and brass sheet, strip, and coil. Since 2000 about 30 percent of the U.S. manufacturing facilities that were customers of the mill have shut down or moved offshore.

One of Revere's largest remaining customers recently presented Revere with a cost comparison of sourcing centrifugal chillers from China versus the USA. Revere supplies copper strip for these chillers. The first exhibit on the chart boards, which is the same as Exhibit 6 attached to my written testimony, shows how the costs would compare without the protectionist currency manipulation by China.

Note that the total costs are about the same for both countries. Indeed, if freight costs to the USA were added the delivered cost of the chiller produced in China would be higher than the chiller produced in the USA.

In the next exhibit, the cost of the product from China is adjusted to reflect the currency manipulation by China of 40 percent. Then, as you can see in the third exhibit, products from China also benefit from a 17 percent VAT rebate on exports to the USA. This results in a price war that American factories cannot win.

Indeed, China is waging a mercantile war on the world and the world is sleeping. Why is the world sleeping? First we must look at the role of the multinationals. Remember in the 1980s when Japan was such a fierce competitor in so many U.S. markets. The reaction, as has been stated today, by our largest corporations was loud and largely one voice, calling for tariffs and restraints. Contrast that with today as most of the largest U.S. corporations are so much more international and produce in or outsource components from China. Many of the largest investment banking firms in the world are headquartered on Wall Street, but derive half or more of their income from foreign sources ranging from managing the reinvestment of U.S. dollars flowing overseas to the construction of manufacturing facilities in China. Unquestionably they are beholden to the government of China.

If manufacturing in America must compete with the protectionist policies of any foreign government, that is not fair. And if meaningful corrective action by U.S. manufacturing and investment banking firms who gain from such protectionism, that's wrong.

CEOs of such multinational corporations are put in a very difficult position when considering national trade policies. They have to choose between their company and their country. So who should America listen to for advice on trade and tax policy? Obviously, none of the above.

The Members of this Committee should take note that tomorrow the Senate Finance Committee is going to mark up legislation by Senators Baucus and Grassley that appears to address currency manipulation. It has several fatal flaws, including making remedies contingent on the President, as well as a Treasury Department finding that a country has, "failed to adopt appropriate policies to eliminate the fundamental misalignment," of its currency. This is the same Treasury Department that does such a good job of representing its friends on Wall Street by consistently failing to cite China for manipulating its currency.

Nor does the bill allow injured manufacturing companies in the USA like Revere to file for countervailing duties to offset the subsidization of China's currency. As such, the bill represents a cruel hoax on the American factory worker who is expecting real relief from the impact of the protectionist policies of China.

I am making a public appeal to Senator Schumer. After 4 years of delay, now is the time to support effective legislation for your Main Street upstate constituency, which is in tatters. The current bill represents manufacturing workers, but they're located in China, not the USA.

Tomorrow, Senators Stabenow, Conrad, Bunning, and Snowe are going to introduce amendments that provide direct remedies to industry and workers in the USA. Of course, Wall Street lawyers say this amendment makes the bill noncompliant with WTO rules. But I can assure you that the Main Street lawyers who you should trust have the opposite opinion. I have here three such opinions you can trust that I would like entered in the record.

[The material referred to follows:]

FISHER-BARTON, INC.
Watertown, WI, September 21, 2006

Hon. JOHN ENGLER,
President and Chief Executive Officer,
National Association of Manufacturers,
Washington, DC.

Dear Governor Engler:

I and my fellow board members listed below have supported the resolution passed at the June 27, 2006 meeting of the NAM IEPC that will be reviewed at the meeting of the NAM Board of Directors next week.

This letter is prompted by your September 15th letter forwarding to NAM board members an opinion by Greenberg Traurig on the consistency of H.R. 1498, the Ryan-Hunter bill, with the obligations of the U.S. as a Member of the WTO. In your letter you state that the analysis by James Bacchus and Ira Shapiro of that law firm "shows that the provisions of H.R. 1498 appear incompatible with WTO obligations."

We respectfully disagree with that conclusion and feel it is only right that an alternative analysis is presented to the entire Board on this issue, especially since those of us who worked with the IEPC on this legislation for over a year and a half have repeatedly asked for specific legal issues with the bill and received none until this one at the last minute. We concur with you that WTO legality is critical to the NAM's support of any trade initiative. The Ryan-Hunter bill was written to achieve consistency with the WTO's agreements, and we believe that it succeeds in achieving that goal.

Indeed, in certain respects, the Greenberg Traurig letter is supportive of the Ryan-Hunter bill (for example, in finding that manipulative undervaluation of a foreign currency confers a "benefit" upon an exporter within the meaning of the WTO's Agreement on Subsidies and Countervailing Measures ("SCM")). In our judgment, however, the Greenberg Traurig letter is flawed in other fundamental aspects (as explained in more detail in the enclosed opinion by Kelley Drye Collier Shannon):

- Exchange-rate manipulation does involve a governmental "financial contribution" and is not a legitimate exercise of a country's "general regulatory powers" for purposes of the SCM Agreement.
- The governmental "financial contribution" can be seen as a direct transfer of funds or as a governmental provision of goods or services to exporters. While not strictly required by the SCM Agreement, there are real costs to the foreign government in making this "financial contribution" (such as the extensive costs entailed with "sterilizing" the foreign government's currency).
- Exchange-rate manipulation creates an incentive to export and clearly benefits only those who export, so that this subsidy is contingent upon exportation and

prohibited under the SCM Agreement. There is no requirement expressed in the SCM Agreement that a subsidy must be exclusively tied to exportation in order to be export-contingent and prohibited.

H.R. 1498 is an important, carefully crafted, and well-reasoned effort to build on the clear intent and developing precedent of WTO law to eliminate trade-distorting subsidies. The currency policy now practiced by China and some other trading partners is the type of export subsidy WTO agreements are meant to prohibit and to provide a remedy against the resulting injury. We believe H.R. 1498 can be successfully defended against any potential challenge at the WTO.

NAM members and other U.S. companies have every right to benefit from trade with other countries and investment abroad. However, these benefits cannot outweigh the injury done to domestic manufacturers because of unfair trade advantages caused by prohibited currency manipulation. For this reason, while we would prefer to work by consensus, we value the NAM for providing an effective forum for U.S. manufacturers to act decisively on critical issues like this and we believe debate and voting are a healthy part of that process. The IEPC resolution was passed due to the active involvement by many smaller NAM members who have become activists because of the injury they are experiencing from the unfair practices of some of our trading partners and should be upheld by the NAM's Board.

Enclosed are two documents: (1) a legal memorandum from Kelley Drye Collier Shannon regarding WTO consistency of H.R. 1498 (Ryan-Hunter); and (2) a background memorandum about currency manipulation, the NAM's policy positions, and the reasons why H.R. 1498 is the best available policy response to currency manipulation.

We would appreciate your sending this letter with its enclosures to the NAM's Board of Directors in advance of next week's meetings. Thank you.

Very truly yours,

RICHARD L. WILKEY, *President,* Fisher-Barton, Inc.	L. PATRICK HASSEY, *Chairman, President and Chief Executive Officer,* Allegheny Technologies Incorporated.	M. BRIAN O'SHAUGHNESSY, *President and Chief Executive Officer,* Revere Copper Products, Inc.

ENCLOSURE 1

Currency Undervaluation: What it Does, How it Violates NAM Principles, and Why H.R. 1498 Is the Best Solution

As with other commodities, the value of a currency is a function of supply and demand. When market forces are free to determine the value, currencies move up and down as conditions change. However, when a government intervenes in currency markets to maintain an undervalued currency, it generates powerful and systematic advantages in its international trade.

With regard to its exports, an undervalued currency conveys a subsidy if and when a good is shipped across the border. As shown in the attachment, the government by its intervention decides how much extra domestic currency an exporter of goods or services (such as tourism) will receive for each dollar it earns. That bonus is a subsidy provided by the foreign government. Under WTO rules, a subsidy benefit that is received contingent on export is prohibited. The prohibition rests on the longstanding legal judgment that export subsidies are inherently distortive and destructive of free and fair competition.

With regard to the country's imports, an undervalued currency serves as a hidden tax on all imported goods and services. The attachment shows clearly that undervaluation creates the need for importers, or would-be importers, to pay extra in domestic currency to purchase each dollar of foreign goods. Whether viewed as a hidden tariff or a hidden tax, the undervalued currency undermines the level playing field for imported products and distorts free and fair competition.

The bottom line is that persistent currency undervaluation maintained by government intervention is incompatible with free trade and violates the letter as well as the spirit of the WTO agreements.

Currency Undervaluation Violates NAM Principles

In 2005, the Board approved two specific sets of priorities for NAM—one an overall trade agenda; the other, a China-specific agenda. The principles and specific objectives in those documents provide a strong basis for condemning persistent currency undervaluation.

Specifically, NAM's established policy objectives include:

- *Eliminate trade-distorting subsidies & defend, preserve and enhance the effectiveness of WTO-consistent U.S. trade law.* As noted above, export subsidies are prohibited because they are the most distortive of free trade.
- *Elimination of artificially created and maintained competitive advantages through WTO-inconsistent subsidization or other means.* As shown in the attachment, currency undervaluation creates powerful advantages for a country's exports as well as for domestic producers competing with imports.
- *Revalue the Chinese Yuan to Reflect Economic Fundamentals.* The Board agreed that this step is viewed as "essential to creating more balanced and sustainable trade flows," "giving U.S. companies a more stable period to adjust to changing economic relationships," and "enabling other countries to free their [undervalued] currencies to better reflect market conditions."
- *Immediate Revaluation of the Yuan by up to 40 Percent.* This objective was ratified by the Board in early 2005. Since then, the yuan has strengthened *vis-à-vis* the dollar by only 4.46 percent through September 20, 2006, according to figures published by NAM. In fact, this very modest, *nominal* appreciation has been exceeded by China's inflation during this same period, so that the yuan is actually weaker in *real* terms than it was in July 2005.
- *Apply Countervailing Duty Laws to China to Offset the Effects of Chinese Subsidies.* The Board agreed that "[t]he size of China's industrial sector and its huge foreign exchange reserves should dictate that greater subsidy discipline be applied." The need for such legislation has been heightened by China's failure to fulfill its commitment to eliminate all export subsidies by the time of its accession to the WTO on December 11, 2001.

Supporting a WTO-consistent remedy against persistently undervalued currencies is a logical next step in NAM's traditional support for free and fair trade, the rule of law in international trade, and the elimination of trade-distorting subsidies. It would validate NAM's leadership role on currency issues that led to the establishment of the Coalition for a Sound Dollar and the Fair Currency Alliance. It would underscore that WTO-consistent responses to mercantilism and protectionism by our trading partners is a key step in strengthening support in the United States for further trade liberalization.

Why H.R. 1498 is the Best Approach

H.R. 1498, introduced by Rep. Tim Ryan (D–OH) and Armed Services Chairman Duncan Hunter (R–CA), is the only bipartisan, WTO-consistent legislation that provides a remedy to persistent currency undervaluation. Thus far, 176 House members have cosponsored the bill, including 85 Republicans. As the 109th Congress draws to a close, H.R. 1498 stands out from all other currency legislation because:

- Consistent with the anti-subsidy rules of the WTO, it makes "currency manipulation"—undervaluation maintained by government intervention in any country—an export subsidy actionable under the U.S. countervailing duty law. The statute would apply in a nondiscriminatory way to all countries. The legislation addresses an unfair, mercantilist practice as a matter of principle and does not single out any foreign country for discriminatory treatment.
- Consistent with the International Monetary Fund's standards, a temporarily undervalued currency resulting not from government interference but from an imbalance in market forces would not be liable to CVD duties.
- Consistent with established national trade law, domestic producers would be required to prove material injury caused by the subsidized imports to obtain offsetting duties. Frivolous cases would be screened out.
- Application of CVD remedies would be contingent on the exporting country's continued intervention to maintain an undervalued currency. Once the practice stops, the remedy stops. Thus, good behavior is rewarded.
- Enactment of H.R. 1498 would provide an avenue of relief for injured industries, encourage foreign governments to desist in the market interference to suppress the value of their currencies, and act as a deterrent to this unfair practice in the future.

H.R. 1498 is good policy and deserves NAM's endorsement.

The Simple Arithmetic of Currency Undervaluation: The Chinese Example

Assume:

- A market value for RBM of $1 = 5 RMB
- An administered value for RMB of $1 = 8 RMB
- An identical product is produced in the U.S. and China at a cost of US$100 or 500 RMB

A would-be Chinese buyer of the U.S. good would have to be able and willing to pay:

 500 RMB—market value of good
+300 RMB—currency penalty

 800 RMB

Result: Huge Cost Disadvantage for U.S. Exporter

A would-be Chinese seller to the U.S. would be able to sell it at:

 500 RMB—market value of good
+300 RMB—currency bonus

 800 RMB

Result: Huge Cost Advantage for Chinese Exporter

ENCLOSURE 2

KELLEY DRYE COLLIER SHANNON
Washington, DC, September 21, 2006

Memorandum
To: Governor JOHN ENGLER
From: DAVID A. HARTQUIST
JEFFREY S. BECKINGTON

RE: THE WTO-CONSISTENCY OF H.R. 1498, THE RYAN-HUNTER BILL

This memorandum is being sent to you on behalf of the China Currency Coalition ("CCC") and responds to an analysis provided to Mr. Jim Jarrett in a letter dated September 12, 2006, by Messrs. James Bacchus and Ira Shapiro of Greenberg Traurig, LLP. In their opinion, H.R. 1498's treatment of manipulative undervaluation of a foreign currency as a countervailable, prohibited export subsidy would likely be found in dispute settlement to be WTO-inconsistent. The CCC respectfully disagrees.

We would like to note at the outset that the Ryan-Hunter bill has been crafted to comply with the rights and obligations of the United States under the WTO's various agreements, including particularly the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). It also should be observed that any legal contest at the WTO on this matter would be a case of first impression, so it cannot be known with absolute certainty what the final result of such proceedings would be. Nonetheless, H.R. 1498 has been scrutinized repeatedly since its introduction in April 2005, and 176 Members of the House of Representatives, virtually evenly split by party, have signed on as co-sponsors.

Under the circumstances, having now been able to read Greenberg Traurig's letter, we continue to believe that H.R. 1498 is WTO-consistent. Indeed, Greenberg Traurig's letter in significant respects supports or concurs with the reasoning that underlies the CCC's position. In the limited areas of disagreement that exist and in its outcome, Greenberg Traurig's evaluation is very much open to challenge. On balance, by far the better view is that the Ryan-Hunter bill is WTO-consistent. The CCC's further points follow.[1]

[1] Importantly, at page 2 of Greenberg Traurig's September 12th letter, H.R. 1498's definition of "exchange-rate manipulation" for purposes of amending the U.S. countervailing duty statute has been misquoted in a way that wrongly suggests that amendment would apply only to China. In actuality, Section 3 of H.R. 1498 defines "exchange-rate manipulation" as a countervailable, prohibited export subsidy so as to apply in countervailing duty proceedings to *any* foreign country (not just China) engaged in manipulative undervaluation of its currency. The definition of "exchange-rate manipulation" cited by Greenberg Traurig's letter concerns Section 4 of H.R. 1498, which deals with the China-specific market disruption provisions in U.S. law based upon China's Accession Agreement with the WTO. Any implication that H.R. 1498 singles out China for discriminatory treatment under the U.S. countervailing duty statute is erroneous.

- The CCC agrees that a measure constitutes a "subsidy" under the SCM Agreement only if (a) there is a governmental "financial contribution" involved, and (b) a "benefit" to the recipient is thereby conferred.
- Greenberg Traurig's evaluation acknowledges that exchange-rate manipulation likely would be found in dispute settlement to confer a "benefit." The CCC concurs. When a country's currency is manipulatively undervalued in relation to the United States dollar, goods from that country that are sold in the United States will realize for the exporter—upon conversion of the dollars into the exporter's home currency—more of that country's currency than if that currency were valued realistically in accordance with market forces. That difference, resulting in additional funds for the exporter, assuredly yields a "benefit" for the exporter.
- Greenberg Traurig's opinion is that exchange-rate manipulation would likely not be considered to be a governmental "financial contribution" and so would not be a "subsidy" under the SCM Agreement. To the contrary, the CCC submits that exchange-rate manipulation does constitute or produce a governmental "financial contribution" either as a direct transfer of funds by the foreign government to the exporter or as a governmental provision of goods or services to the exporter in which the foreign government is selling its currency and buying U.S. dollars. The foreign government prints the money and decides how much to give to each exporter.
- In Greenberg Traurig's view, a governmental "financial contribution" is not likely to be found (a) because the foreign government's manipulative undervaluation of its currency is an exercise of its "general regulatory powers"; and (b) because there is no "real cost" to the foreign government from a transfer of economic resources, as there is with an outright grant of governmental funds or a loan at below-market rates. But these attempted claims should fail. The vague yardstick of whether a measure is an exercise of "general regulatory powers" would wrongly excuse many measures like grants and preferential loans that already are recognized as governmental "financial contributions." Moreover, not only is the notion of a "real cost" to the foreign government not articulated or defined in the SCM Agreement as a prerequisite for a governmental "financial contribution," but exchange-rate manipulation does actually entail substantial costs for the foreign government. Such manipulation requires an extensive and costly regulatory system by the foreign government to maintain, not least the process of "sterilizing" the foreign government's currency to avoid inflation. Again, there are solid grounds to treat exchange-rate manipulation as a "subsidy" under the SCM Agreement that involves both a governmental "financial contribution" and a "benefit" for the recipient.
- Greenberg Traurig's analysis also argues that the third criterion under the SCM Agreement for a prohibited export subsidy would not be met and that payments to an exporter by a foreign government's exchange-rate manipulation are not "contingent" upon export performance, if the exchange rate is available to anyone who has U.S. dollars to be exchanged into the manipulatively undervalued foreign currency. But the fact remains that the foreign country's exporters can only receive their home currency at the subsidized, advantageous rate by exporting and obtaining U.S. dollars. Availability of the subsidized rate to other groups, such as foreign investors or tourists (who are importers of services, such as lodging and transportation, as well as purchasers of goods to carry home), does not at all dictate a conclusion that the subsidy is not export-contingent. There is no requirement expressed in the SCM Agreement that a subsidy must be exclusively tied to exports in order to be export-contingent and prohibited. This distinction has been recognized and prohibited export subsidization has been found in dispute settlement at the WTO in similar situations. The fundamental issue is whether the subsidy creates an incentive to export; an undervalued currency clearly benefits only those who export.

In summary, the CCC continues to believe that exchange-rate manipulation is a countervailable, prohibited export subsidy and would be considered as such in a dispute settlement at the WTO.

WILEY REIN & FIELDING LLP

RE: RESPONSE TO THE BACCHUS-SHAPIRO ANALYSIS OF THE CONSISTENCY OF H.R. 1498, THE HUNTER-RYAN BILL, WITH THE WTO OBLIGATIONS OF THE UNITED STATES

In their letter to the National Association of Manufacturers ("NAM") dated September 12, 2006,[1] James Bacchus and Ira Shapiro comment on the consistency of H.R. 1498 with the WTO obligations of the United States. They conclude that the Chinese exchange rate regime "probably does not fall within the meaning of 'subsidy' as defined by the WTO Agreement on Subsidies and Countervailing Measures, and even if it does, it is neither a prohibited nor an actionable subsidy under that Agreement." (Letter at 11.) In this response, we evaluate the Bacchus-Shapiro analysis and conclude, contrary to their views, that there are persuasive reasons why H.R. 1498 could be deemed consistent with the U.S. obligations under the Agreement on Subsidies and Countervailing Measures ("SCM") in the event it is challenged at the WTO.

A. The Subsidy Defined by H.R. 1498

Before turning to their WTO analysis, we note that the Bacchus/Shapiro Letter incorrectly describes the amendment to the countervailing duty law proposed by H.R. 1498.[2] While it is true that the introduction to H.R. 1498 states that its purpose is to "clarify that exchange rate manipulation by the People's Republic of China is actionable under the countervailing duty provision . . .," the actual amendment proposed to the countervailing duty law would not be limited to China. In the proposed amendment to the countervailing duty law, H.R. 1498 states:

> [T]he term 'exchange-rate manipulation' means protracted large-scale intervention by an authority to undervalue its currency in the exchange market that prevents effective balance-of-payment adjustments or that gains an unfair competitive advantage over any other country.

Thus, the amendment would apply to any country that manipulates its exchange rate, not just China.

This is not an insignificant oversight. An amendment to the U.S. countervailing duty law that is country specific would be unquestionably WTO-inconsistent as a violation of the most-favored-nation clause found in Article III of GATT–1994. This result is avoided by H.R. 1498 by making the new countervailing duty provisions relating to currency manipulation generic as they are required to be under the MFN obligation.

B. The Definition of a Subsidy in the SCM Requires a Financial Contribution and Benefit to the Recipient

We agree with the Bacchus/Shapiro conclusion that Article 1.1 of the SCM provides that a subsidy exists only where there is both "financial contribution" and a "benefit." And, we accept their view that a WTO panel likely "would find that 'exchange rate manipulation' does confer a benefit . . ." provided there are facts sufficient to demonstrate that an advantage exists as a result of such action by the government authority. (Letter at 5.)

We do not, however, share the Bacchus/Shapiro expectation of "difficulty" in demonstrating that the Chinese currency regime involves a financial contribution. Article 1.1(a)(1) provides that there is a financial contribution by a government where, *inter alia,* there are direct transfers to the recipient (such as grants, loans, and equity infusions). Bacchus and Shapiro argue that the exchange of U.S. dollars for RMB is not such a transaction and that none of the other three practices defined in Article 1.1(a)(1) are applicable. In their view, it is likely that the WTO would require persuasive evidence "of a real cost to the government from a transfer of economic resources," and that "the existence of a financial contribution involves consideration of the transaction through which something of economic value is transferred by a government." (Letter at 7, quoting *Softwood Lumber* (WT/DS 257/AB/R.)

We fail to see why the settlement of foreign exchange holdings does not amount to a financial contribution. Under the Chinese currency regime, foreign exchange is in many cases, including export receipts, required to be settled through the People's

[1] Letter from James Bacchus and Ira Shapiro of Greenberg, Taurig, to Jim Jarrett, National Association of Manufacturers, September 12, 2006.

[2] The Letter states that "Exchange Rate Manipulation" is defined to mean "protracted large scale intervention by the Government of the People's Republic of China. . . ." This definition is found in the proposed amendment to the special safeguard provision.

Bank of China or a bank authorized to carry on a foreign exchange business.[3] In exchange, the Bank provides RMB to the recipient at the prescribed rate of exchange. As the banks function at the direction of the government, the financial contribution would be deemed made by the government. *See* SCM Article 1.1(A)(1)(iv). This financial contribution from the government confers a benefit—as conceded by Bacchus and Shapiro—because the dollars exchanged are valued at a higher rate than would be the case in the absence of exchange rate manipulation. That is, the recipient does not pay "market rates for what it receives." *Canada-Dairy* (WT/DS103/AB/R), Para 87.

This scenario is indistinguishable from the situation where a government transfers cash to a recipient in return for equity at a price that is above the market value of the asset transferred by the recipient. Such transactions are denied financial contributions because they involve a transfer of cash; they amount to a subsidy because the recipient benefits from the exchange of equity for more value than would have been received from a profit motivated investor. In the case of the Chinese currency regime, there is also a transfer of more cash to the recipient then would be transferred under a market driven exchange rate system, which Bacchus and Shapiro concede confers a benefit.

The language of SCM Article 1.1(a)(1) does not indicate that the definition of "financial contribution" includes an implicit requirement that the transfer must involve a cost to the government. The word "transfer" means simply that there has been a conveyance from one party to another. This ordinary meaning of the word transfer should preclude incorporation of additional criteria. *See* Article 31 of the Vienna Convention on the Law of Treaties, which is the applicable rule of interpretation for WTO dispute resolution.

C. The Subsidy Conferred by the Chinese Currency Regime Is Contingent on Export

Bacchus and Shapiro conclude that even if there is a financial contribution and benefit, the Chinese currency regime is not "tied" to exports. While conceding that the currency benefit is available to exporters, they note that it is equally available to those who receive U.S. dollars from the repatriation of profits and from the inflow of foreign direct investment. Since the subsidy is not limited to exporters, they argue that the WTO would not likely find that the subsidy is contingent on export performance. (Letter at 10.)

Bacchus and Shapiro do make reference to the Appellate Body decision in *United States Upland Cotton* (WT/DS 267/AB/R), where it was determined that export contingency can exist even though the subsidy is not limited to exporters. But, they argue, *Upland Cotton* is distinguishable because in that case, the "Statute and Regulations clearly distinguish between exporters and domestic users." In contrast, they argue, the terms of the Chinese currency regime does not clearly distinguish between "exporters and others. . . ." (*Id.*)

While it is true that the Appellate Body did cite differences in the domestic and export programs as a distinguishing feature in *Upland Cotton,* it did not elevate the existence of a distinction to a preclusive criteria. This interpretation is consistent with the Appellate Body decision in *United States-Tax Treatment for Foreign Sales Corporations, Recourse to Article 21.5 of the DSU by the European Communities* (WT/DSBRO8/AB/RW, 14 January 2002), which states:

> (a) 119. We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced outside the United States and held for use outside the United States. *Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances.* The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States tax player is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. *The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the SCM Agreement, irrespective of whether the subsidy*

[3] *See* Regulations on the Control of Foreign Exchange Settlement, Sale and Payment, Promulgated by the People's Bank of China, June 20, 1996.

given in respect of property produced outside the United States is also export contingent.

The same result should apply here where the foreign exchange regime is applicable to more than exporters.

There is reason to believe that a WTO review of the Chinese currency regime would take note of the fact there are numerous special rules and exceptions applicable to holders of foreign currency other than exporters. Not every dollar received in China must be settled in the same fashion. For example, while the Regulations of the People's Bank of China require settlement of foreign exchange earned by domestic organizations from a variety of sources, including foreign exchange earned from export, remission of profits from foreign assets, transfer of patent rights, etc., there are numerous special regulations that allow foreign exchange accounts that are not available to exporters *per se.* Such accounts may be utilized by recipients of foreign exchange from participation in overseas projects, for foreign agency services, receipts of travel agencies and certain insurance premiums. In addition, there are special regulations applicable to enterprises with foreign investment which also allow foreign exchange accounts not available to exporters.[4] These differentials in the treatment of foreign exchange receipts by domestic companies demonstrate that the "subsidy" is not simply tied to having dollars as Bacchus and Shapiro contend. These differences indicate that the Chinese currency regime does distinguish between exporters and others, which suggests that even the most restrictive reading of *Upland Cotton* criteria would permit the characterization of the Chinese currency regime as contingent on export.

STEWART AND STEWART
Washington, DC, September 22, 2006

RE: RESPONSE TO BACCHUS/SHAPIRO ANALYSIS OF WTO—CONSISTENCY OF HUNTER-RYAN BILL (H.R. 1498)

A. Introduction

The following analysis is offered to provide a response to the September 12, 2006, memorandum prepared for NAM by James L. Bacchus and Ira Shapiro (hereinafter "Bacchus/Shapiro memo"). That memo concludes that the Chinese exchange rate regime is not a prohibited (or actionable) subsidy under the SCM Agreement and, therefore, H.R. 1498 (the Hunter-Ryan bill) is unlikely to be WTO-consistent at least as applied to China. The authors are well-known and well-regarded trade law practitioners, and their views on WTO matters should certainly be respected. However, reasonable minds may disagree about issues such as the WTO-consistency of proposed legislation where no directly similar measure has previously been considered by a WTO dispute settlement panel or the Appellate Body. In addition, the Bacchus/Shapiro memo recognizes the seriousness of the problem and does not suggest that nothing should be done to address it. Rather, they suggest that the chances of a successful offensive challenge to the Chinese currency regime based on a GATT 1994 Article XV:4 violation would be better than the chances of a successful defense of H.R. 1498 in a WTO dispute. The initiation of such an offensive challenge was, of course, the purpose of the Section 301 petition filed by the China Currency Coalition ("Section 301 petition"), which unfortunately was not accepted by the Administration.

The Bacchus/Shapiro memo acknowledges that the question of whether a measure is a prohibited (or actionable) subsidy under the SCM Agreement requires a highly fact-specific analysis. The memo then proceeds on the basis of the authors' understanding of the operation of the Chinese currency regime without considering the practical implications and effects of that regime on Chinese exporters. Bacchus/Shapiro memo, at 2–3. Instead, the memo finds two fundamental problems that they view are likely to weigh against a WTO panel finding that the Chinese exchange rate regime is a prohibited export subsidy within the meaning of Article 3.1(a) of the SCM Agreement. First, the memo foresees difficulty in arguing that the regime provides a "financial contribution" or "income or price support" and, thus, does not provide a subsidy within the meaning of Article 1.1(a) of the SCM Agreement. Second, the memo concludes that even assuming *arguendo* that the regime does provide a subsidy, the subsidy is not contingent *in fact* on export performance.

Because there are differing views on these fact-intensive issues, as evidenced by the Section 301 petition, and because any challenge of H.R. 1498 would be a case of first impression for the WTO, we provide the following supplemental analysis,

[4] Regulations, Article 10.

which concludes that, while the WTO-consistency of any U.S. law is subject to possible challenge, there are strong arguments that H.R. 1498 is consistent with U.S. obligations under the SCM Agreement.

B. Financial Contribution

According to the Bacchus/Shapiro memo, the government's pegging of the value of the yuan to the value of the U.S. dollar does not "involve a transaction of the nature, or the kind of transfer of economic resources, that constitutes a 'financial contribution' under any of the subparagraphs of Article 1.1(a)(1)" of the SCM Agreement. Bacchus/Shapiro memo, at 7. Likewise, the Bacchus/Shapiro memo finds that exchange-rate manipulation would not be a form of income or price support in the sense of GATT Article XVI and within the meaning of Article 1.1(a)(2) of the SCM Agreement. Bacchus/Shapiro memo, at 8. According to the memo, Article 1.1(a)(2) is likely to refer to conventional income or price support programs for specific products intended to maintain income or prices at levels higher than they otherwise would be.[1]

It is not clear, however, why the exchange of currency at an undervalued rate would not be a "direct transfer of funds" or at the very least government revenue foregone within the meaning of SCM Agreement Articles 1.1(a)(1)(i) or (ii). According to the Appellate Body, "a 'subsidy' involves a transfer of economic resources from the grantor to the recipient for less than full consideration."[2] [3] *US—DRAMS CVD,* WT/DS296/AB/R, para. 125, n. 212, citing *Canada—Dairy,* WT/DS103/AB/R, WT/DS113/AB/R, para. 87. While the Appellate Body in *US—Softwood Lumber IV* recognized that "not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a)," it also recognized that a "wide range of transactions" and "government measures" fall within the meaning of that provision. WT/DS257/AB/R., para. 20, n. 35. In other words, a "financial contribution" is not limited to a governmental transfer of money directly to the recipient.

For example, in *US—Softwood Lumber IV,* the Appellate Body considered whether Canadian provinces provided a financial contribution by "provid[ing] goods" within the meaning of SCM Agreement Article 1.1(a)(1)(iii). The Appellate Body explained that it was the *consequence* of the transaction that must be considered in determining whether or not the government has provided goods. *Id.* at para. 43. In that case, stumpage arrangements gave tenure holders *a right* to enter onto government lands, cut standing timber, and enjoy exclusive rights over the timber that was harvested. The Appellate Body concluded that the consequence of the transaction was that the government provided harvesters with standing timber. *Id.* The Appellate Body further noted that the evidence suggested that "making available timber is the *raison d'etre* of the stumpage arrangements." *Id.* Therefore, the Appellate Body upheld the panel's finding that the U.S. determination that the Canadian provinces provided a financial contribution in the form of goods by providing standing timber to timber harvesters through stumpage programs was "not inconsistent" with Article 1.1(a)(1)(iii). *Id.* at para. 76.

The Appellate Body in the *EC—Sugar* case has also broadly construed Agriculture Agreement Article 9.1(c), which imposes reduction commitments on export subsidies provided through "payments on the export of an agricultural product that are financed by virtue of governmental action. . . ." The Appellate Body in *EC—Sugar* upheld the panel's conclusion that the government's cross-subsidization of the production of C sugar constituted a "payment" in the form of transfers of financial resources on export financed by virtue of governmental action resulting from the operation of the EC sugar regime within the meaning of Article 9.1(c):

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[1] Unlike the Bacchus/Shapiro memo, the Section 301 Petition relies on the Second Report on AD/CVD Duties adopted in 1960 as well as a panel report in *Brazil—Aircraft* to argue that a financial contribution does not require a "payment" but can include "measures having an equivalent effect." Section 301 petition at 59–60, n. 67. According to the Second Report on AD/CVD Duties, "the word 'subsidies' covered not only actual payments, but also measures having an equivalent effect." BISD 9S/194, 200, para. 34.

[2] *See also US—Softwood Lumber IV,* WT/DS257/AB/R, para. 19 ("The concept of subsidy defined in Article 1 of the *SCM Agreement* captures situations in which something of economic value is transferred by a government to the advantage of the recipient").

[3] While the Bacchus/Shapiro memo, at 6, notes that the Appellate Body in the *US—DRAMS CVD* dispute was reluctant to find that a Member's exercise of general regulatory powers constituted a "financial contribution," the Chinese exchange rate regime is more than an exercise of general regulatory powers. Moreover, the *US—DRAMS CVD* case involved an alleged indirect financial contribution through a private body under SCM Agreement Article 1.1(a)(1)(iv) not a "direct transfer of funds" or government revenue foregone within the meaning of SCM Agreement Articles 1.1(a)(1)(i) or (ii). *US—DRAMS CVD,* WT/DS296/AB/R, para. 115.

> 7.331 The Panel is thus of the view that EC sugar producers *finance* sales of C sugar at below cost of production directly by participating in the domestic market and making sales internally at *high prices as regulated by the European Communities* (and from the purchase of discounted C beet as discussed earlier). The European Communities' governmental action controls virtually all aspects of domestic sugar supply and pricing. *The European Communities provides this control through a combination of guaranteed intervention prices, production quotas and import restraints which limit the quantity of quota sugar that may be sold in the internal market, and the resulting high domestic price for A and B quota sugar.* The domestic sales offer lucrative and attractive returns to producers. Government action controls the supply of domestic sugar by way of quotas in pursuit of protecting high domestic prices well above the intervention price.
>
> Additionally, *penalties levied against sugar producers that divert C sugar production into the domestic market are evidence of further governmental control. The collection of production levies and distribution of export refunds also contribute to the high degree of EC governmental control. Last, the imposition of high import tariffs illustrates again governmental action in the EC sugar regime.*
>
> 7.332 Accordingly, the EC sugar regime uses the high profits on A and B quota sugar to cover fixed costs for C sugar and, most importantly, *requires C sugar to be exported and diverted from the domestic market.* Again, the result of the EC sugar system is not the production of C sugar in marginal or superfluous amounts simply in the pursuit of ensuring quota fulfillment. Rather, as the EC Court of Auditors stated, over the past years, C production has varied between 11 and 21 percent of quota production, a significant portion of the European Communities' entire sugar production.
>
> 7.333 In the Panel's view, the EC sugar regime and the cross-over benefits that it creates are thus *the direct and foreseeable consequences of actions by the European Communities,* within the meaning of Article 9.1(c) of the *Agreement on Agriculture,* not merely the decisions of private sugar producers responding to market incentives.
>
> 7.334 *Therefore, the Panel finds that the production of C sugar receives a payment, through cross-subsidization resulting from the operation of the EC sugar regime; there is a payment. in the form of transfers of financial resources on export financed by virtue of governmental action.*
>
> 7.335 Pursuant to Article 10.3 of the *Agreement on Agriculture,* the Panel finds that the European Communities has not demonstrated that exports of C sugar that exceed the European Communities' commitment levels since 1995 and in particular since the marketing year 2000/2001, are not subsidized. Consequently, the European Communities is acting inconsistently with Articles 3 and 8 of the *Agreement on Agriculture.*

WT/DS265/R, WT/DS266/R, WT/DS283/R, paras. 7.331–35 (emphasis added); WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, para. 278.

Likewise, in *Canada—Dairy,* the Appellate Body found that Canada's dairy regime constituted an export subsidy under Agriculture Agreement Article 9.1(c) because the provision of milk at reduced or below market prices constituted "payments" within the meaning of Agriculture Agreement Article 9.1(c). The Appellate Body specifically considered whether the transfer of economic resources constituting a "payment" within the meaning of Article 9.1(c) had to be in the form of money or could take other forms. WT/DS103/AB/R, WT/DS113/AB/R, para. 107. In the Appellate Body's view, the payments could be made in a form, other than money, that confers value, such as by way of goods or services, and includes revenue foregone. *Id.* at 107, 112. The Appellate Body explained that the "foregoing of revenue usually does not involve a monetary payment." *Id.* at para. 110 (citing Agriculture Agreement Article 1(c)). The Appellate Body found that the provision of milk at discounted prices to processors for export constituted non-monetary "payments" within the meaning of Article 9.1(c) in an amount equal to the portion of the price not charged. WT/DS103/AB/R, WT/DS113/AB/R, para. 113.

While Article 9.1(c) of the Agriculture Agreement is not identical to Article 1.1(a) of the SCM Agreement, the Appellate Body's recognition that a "payment" on the export of agricultural products can occur through the effects of a government regime should not be overlooked.

The plain language of Article 1 of the SCM Agreement and the WTO case law to date confirm that a government need not issue a check to an exporter to provide a "financial contribution." As explained in the Section 301 petition, China's currency regime provides a real financial contribution to Chinese exporters through the exchange of currency at an undervalued rate:

> The Chinese government requires its citizens to exchange their dollars for local currency, sets the rate of exchange by fiat, and prints the money to fund the transaction. By directing the conversion of U.S. dollars at an extremely undervalued rate of 8.28 Yuan for each U.S. dollar, the Chinese government provides a financial contribution. . . .

Section 301 Petition, at 60. In other words, the Chinese exchange rate regime requires banks to exchange U.S. dollars *by overpaying them* Chinese Yuan. The additional Chinese Yuan received by exporters in the form of cash represents a direct transfer of funds, within the meaning of SCM Agreement Article 1.1(a)(i), or at the very least government revenue foregone, within the meaning of Article 1.1(a)(ii).[4] The Section 301 petition also suggested that:

> China's currency manipulation further contributes financially to Chinese exports to the United States and elsewhere by shielding Chinese exporters from expenses involved with hedging against foreign-exchange losses or purchasing guarantees to guard against exchange-rate fluctuations. These costs are avoided thanks to the Chinese government's guarantee of a substantially undervalued, pegged-exchange rate that prevents any currency fluctuations between the Yuan and the U.S. dollar.

Id. at 61. Moreover, the currency exchange can also be viewed as a financial contribution because it provides Chinese exporters a "service" at non-market rates within the meaning of Article 1.1(a)(1) (iii). Hence, while the Bacchus/Shapiro memo conservatively concludes that the "financial support" requirement is not met, a review of the WTO case law set out above supports a contrary conclusion, and the particular facts at issue have never been considered in a WTO dispute settlement proceeding.

C. *De Facto* Contingent Upon Export Performance

The Bacchus/Shapiro memo concludes that, assuming *arguendo* that the Chinese currency regime is a subsidy, it is not a prohibited export subsidy because its grant is not "tied to" exports. Bacchus/Shapiro memo, at 9.

With respect to *de facto* export contingency, footnote 4 to Article 3.1(a) of the SCM Agreement states that the standard "is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision." Thus, the critical issue is whether or not the grant of the subsidy is "tied to" actual or anticipated exportation or export earnings.

There have been at least two adopted panel or Appellate Body decisions finding *de facto* export contingency within the meaning of Article 3.1(a): *Australia—Automotive Leather II* and *Canada—Aircraft.* According to the adopted panel report in *Australia—Automotive Leather II,* the sales performance targets set out in the grant contract constituted export performance targets because (1) the government was aware that the producer would have to continue and probably increase exports to reach the targets, and (2) the Australian market was already too small to absorb the producer's production, much less any expanded production that might result from financial benefits accruing from the grant payments and required capital investments which were to be specifically for automotive leather operations. *Australia—Automotive Leather II,* WT/DS126/R, paras. 9.67, 9.71. Therefore, the panel found that the producer's "anticipated export performance was one of the conditions for the grant of the subsidies" and was compelling evidence of a close tie between anticipated exportation and the grant of the subsidies. *Id.*

The Appellate Body in *Canada—Aircraft* upheld the panel's finding that the TPC program was *de facto* export contingent. In doing so, the Appellate Body explained that the legal standard to establish *de jure* and *de facto* contingency was the same, but the evidence required to establish their contingency differed. Specifically, proof of a *de facto* export contingency is based on an inference from the "total configuration of the facts constituting and surrounding the granting of the subsidy, none of

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[4] The Section 301 petition points out correctly that "[t]o the extent that the Chinese government entrusts or directs any private bodies to assist in effectuating the yuan's undervaluation, which assistance appears also to take place, the conclusion still holds under Article 1.1(a)(1)(iv) that the Chinese government is providing a financial contribution and service as defined by the SCM Agreement." Section 301 petition at 60, note 68.

which on its own is likely to be decisive in any given case." *Canada—Aircraft,* WT/DS70/AB/R, para. 167. The Appellate Body then agreed with the panel that the relevance of particular facts will depend on the circumstances of the particular case and that "there can be no general rule as to what facts or what kinds of facts *must* be taken into account." *Canada—Aircraft,* WT/DS70/AB/R, para. 169.

Interpreting the language of footnote 4, the Appellate Body explained that the words "tied to" in footnote 4 required that a relationship of *conditionality* or *dependence* must be demonstrated. *Canada—Aircraft,* WT/DS70/AB/R, para. 171. The Appellate Body also interpreted footnote 4 as not permitting an affirmative finding based solely on (1) evidence that a government granting a subsidy *anticipated* that exports would result, or (2) evidence that a government knew that a recipient's sales were export-oriented. *Canada—Aircraft,* WT/DS70/AB/R, paras. 169–173. While evidence of these facts may be taken into account, they cannot support an affirmative finding alone.

Applying the legal test to the facts in that case, the Appellate Body affirmed the panel's finding that the TPC assistance to the Canadian regional aircraft industry was *de facto* export contingent based on consideration of the sixteen factual elements, including: TPC's statement of its overall objectives; types of information called for in applications for TPC funding; the considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance; factors to be identified by TPC officials in making recommendations about applications for funding; TPC's record of funding in the export field, generally, and in the aerospace and defence sector, in particular; the nearness-to-the-export-market of the projects funded; the importance of projected export sales by applicants to TPC's funding decisions; and the export orientation of the firms or the industry supported. *Canada—Aircraft,* WT/DS70/AB/R, para. 175.

The lack of the requisite "tie" in *Canada—Aircraft II,* however, led the panel in that case to reject allegations of *de facto* export contingency based on the size of the domestic market. Specifically, the panel acknowledged that the government "was very likely aware that the Canadian domestic market was too small to absorb Bombardier production" but concluded that the program was not operated in a way to suggest that the equity guarantees were *de facto* export contingent. *Canada—Aircraft II,* WT/DS222/R, paras. 7.360, 7.377–78. In doing so, the panel distinguished the TPC program discussed in *Canada—Aircraft* which (1) required TPC employees to focus on the volume of export sales resulting directly from the project, (2) involved TPC business plans which recorded the proportion of the aerospace and defense industry's revenue allocable to exports, and (3) involved firms exporting 80 percent of their shipments. *Id.*

In the case of China's currency regime, the subsidy is *de facto* export contingent. As the Section 301 petition explained, "the subsidization would not occur if exports did not occur. In order for the foreign-exchange program to operate, products must be traded internationally. Without export performance, there would be no foreign currency to exchange." Section 301 petition at 65. Thus, there is a "relationship of conditionality or dependence." *Canada—Aircraft,* WT/DS70/AB/R, para. 171. The granting of the subsidy is not based merely on "knowing that a recipient's sales are export-oriented." *Canada—Aircraft,* WT/DS70/AB/R, para. 173. Without exportation there can be no subsidization. Hence, the subsidy provided by China's currency regime is "tied to" exports within the meaning of the SCM Agreement. This conclusion is supported by WTO case law.

D. A Subsidy's Availability to Non-Exporters Does Not Dissolve the Export-Contingent Nature of the Payments to Exporters

The Bacchus/Shapiro memo concludes that a WTO panel would not find the currency regime to be a prohibited export subsidy that is *de facto* contingent on export performance because it lacks the requisite "tie to" exports. Bacchus/Shapiro memo, at 9–10. Instead, the memo explains that any alleged subsidy is "tied to" having U.S. dollars, as a result of foreign profits, foreign investments or from exports. The memo also notes the lack of evidence indicating that exports are singled out for special treatment or subject to different conditions. Bacchus/Shapiro memo, at 10.

Yet, SCM Agreement Article 3.1(a) specifically states that a subsidy can be contingent upon export performance "whether solely or as one of several other conditions." Indeed, the Appellate Body has twice rejected arguments that receipt of subsidy payments by non-exporters somehow dissolves export contingency for exporters. For example, in *US—Upland Cotton,* the Appellate Body rejected the U.S. argument that its Step 2 payments were not export contingent because they were also available to domestic users. *US—Upland Cotton,* WT/DS267/AB/R, paras. 564, 576. The Appellate Body explained that the fact that a subsidy was also available to domestic users did not "dissolve" the export-contingent nature of the payments to exporters.

Id. at para. 578. Rather, the Appellate Body found that program to be *de jure* export contingent because the statute and regulations (1) distinguished between two types of recipients (eligible exporters and eligible domestic users), and (2) established different conditions for each type to receive payments, *i.e.,* an exporter had to demonstrate that the upland cotton had been exported to receive a payment. *Id.* at paras. 576–77.

In doing so, the Appellate Body relied on its decision in *US—FSC (Article 21.5—EC).* In *US—FSC (Article 21.5—EC),* the Appellate Body found that the fact that subsidies may not be export-contingent in all "situations" in which they provide benefits did not affect its conclusion that the subsidy was export-contingent in one of those "situations." WT/DS108/AB/RW, at para. 119. In that case, the ETI measure at issue contemplated two different factual situations, one involving property produced within the United States and held for use outside the United States, and the other involving property produced outside the United States and held for use outside the United States. *Id.* The Appellate Body observed that the conditions for the grant of the subsidy with respect to property produced outside the United States were distinct from those governing the grant of the subsidy in respect of property produced within the United States. *Id.* at para. 114. Therefore, the Appellate Body examined the two situations separately and concluded that the first situation would require the exportation of property produced within the United States to receive the tax exemption. *Id.* at paras. 115, 119. The fact that the same measure grants subsidies that might not be export contingent to those in the second situation did "not dissolve the export contingency arising in the first set of circumstances." *Id.* at para. 119.

Thus, the simple fact that enterprises in possession of dollars from inflows of foreign direct investment or repatriation of profits earned abroad benefit from China's currency regime, along with exporters, does not make the action of the Chinese government any less of an export subsidy. In addition, the value of foreign direct investment in China and Chinese overseas investment (and consequently repatriation of profits) pales in comparison to the value of Chinese exports. In 2005, the value of Chinese exports was US$762 billion,[5] while the value of foreign direct investment in China was only US$60.3 billion[6] and the value of Chinese overseas investment was just US$6.92 billion.[7] Moreover, as the recent WTO Trade Policy Review of China explained, "FDI has served as a platform, enabling China to manufacture products that meet world-market specifications with regard to quality, design, and technological content, thereby greatly contributing to the export orientation of the economy."[8] So, even foreign direct investment is generally oriented toward export production, which in turn leads to greater subsidization through China's currency regime.

In any event, it cannot be the case that a program that primarily benefits exports is deemed to not be an export subsidy simply because a relative handful of non-exporting enterprises also benefit. As explained, WTO case law supports this conclusion.

E. Conclusion

The Bacchus/Shapiro memo addresses the question of whether H.R. 1498 is consistent with the WTO Agreement. With various qualifications which recognize that any actual WTO challenge of any U.S. law treating China's foreign exchange regime as a subsidy would be dependent on the facts of the case presented, the Bacchus/Shapiro memo nonetheless draws the conclusion that such a law would likely be found WTO-inconsistent if challenged by China. We respectfully disagree. While we agree with much of the Bacchus/Shapiro memo's review of the basic elements identified as needing to be addressed, we disagree with the conclusion drawn. As this memo has reviewed, WTO case law supports the view of those who support H.R. 1498. China's foreign exchange rate program should be viewed as a financial contribution, the resulting subsidy is tied to exports such that it is an export subsidy, and hence it is prohibited under the SCM Agreement, or in the least it is actionable and may be addressed by U.S. countervailing duty law.

As is true with any law or regulation adopted by a WTO member government, no one can know with certainty that the law or regulation, if challenged at the WTO, will not be found to violate some aspect of a WTO Article or WTO Agreement.

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[5] Trade Policy Review, Report by the Secretariat, People's Republic of China, Revised, WT/TPR/S/161/Rev.1, at 257, Annex A1.1 (June 26, 2006) ("China TPR").

[6] China TPR, at 24, note 79.

[7] Website of the Ministry of Commerce of the People's Republic of China (MOFCOM), *http://english.mofcom.gov.cn/aarticle/statistic/foreigninvestment/200607/20060702705397.html* (Accessed Sep. 21, 2006).

[8] China TPR, at 5.

The same can be said with respect to review by domestic courts of a law's consistency with the U.S. Constitution or of a regulation's consistency with U.S. law. The Bacchus/Shapiro memo acknowledges this uncertainty as do we. Such uncertainty by itself is not a basis to oppose legislation where existing WTO provisions and decisions provide a basis for believing that the legislative approach would be WTO-consistent. The portion of H.R. 1498 that deals with recognizing that currency manipulation is a countervailable subsidy fairly can be viewed as WTO-consistent. The concerns raised in the Bacchus/Shapiro memo are, in fact, addressable under the facts of the situation as they pertain to China, and as decided by adopted WTO panel and Appellate Body reports.

Sincerely,

TERENCE P. STEWART,
AMY S. DWYER,
J. DANIEL STIRK.

Senator DORGAN. Without objection.

Mr. O'SHAUGHNESSY. I am requesting Senator Schumer as well as Senators Rockefeller, Kerry, Cantwell, Ensign, and Smith of this Committee to join Senator Snowe in supporting effective trade legislation to offset currency manipulation with these amendments.

Ladies and gentlemen, in conclusion, I feel a special trust has been placed in me, handed down from Paul Revere, to represent not only the workers in my company, but the workers throughout the United States, the factory workers. There is no company that more closely represents the interests of Main Street and factory workers in the USA than Revere. Please listen to us. Time is of the essence here as the damage to the economic structure of our Nation and its industrial base worsens every day and many domestic manufacturing companies cannot hold on for much longer. This sense of urgency is no less important to resolve tax issues as well as currency manipulation as they are related and directly linked to the competitive position of USA manufacturing in the world.

Mr. Chairman, thank you for this opportunity to testify.

[The prepared statement of Mr. O'Shaughnessy follows:]

PREPARED STATEMENT OF M. BRIAN O'SHAUGHNESSY, CHAIRMAN, CEO, AND PRESIDENT, REVERE COPPER PRODUCTS, INC.

Who should America listen to for trade and tax policy?

Three million manufacturing jobs have been lost in the USA since the year 2000.

Some attribute it to increased productivity—but previous recoveries typically resulted in a loss of about one million jobs in spite of productivity increases. Even so, some economists cite data that the manufacturing sector is doing just fine as it is producing more than ever before. Such data is misleading and you should consider the source. For example, U.S. produced products include Dell computers which are assembled in the USA from components produced abroad. Foreign outsourcing has a significant impact on productivity and renders the data on productivity useless. Indeed, an article in *Business Week* describes the "Phantom GDP" and states "the growth of domestic manufacturing (and productivity) has been substantially overstated in recent years." This is directly linked by *Business Week* to foreign outsourcing.

We could argue endlessly about this but the facts are the facts and the fact is we have become a nation with a colossal trade deficit.

In 2005, for the first time in over a hundred years, our Nation imported more food products than it exported and our trade deficit in manufactured goods continues to soar. Indeed, our Nation's trade deficit is growing by $2 billion a day! Some think it is our country's responsibility to support fledgling economies because we are the strongest, most powerful nation in the world. Some say we need to set a good example and others will follow.

No matter how we try to rationalize it, millions of manufacturing jobs are going overseas.

My company is Revere Copper Products. We were founded in 1801 by Paul Revere and believe we are the oldest manufacturing company in the USA. Our modern copper rolling mill is in Rome, New York and produces copper and brass sheet, strip and coil. Many of our customers are located throughout the USA and use our products to manufacture industrial or consumer products.

Since 2000, about 30 percent of the manufacturing facilities that were customers of this mill have shut down or moved offshore. It is easy to see for yourself if you simply go to any big box store and look at any item made of copper and brass. Turn the package over and you will likely see that the product is now made in China. That's because the cost of manufacturing in China is so much cheaper, you believe. At least, that is what you have been told . . .

Once you start looking at the facts, however, you will see a very different picture.

Let's say the production cost of a brass doorknob in China is 100 yuan. You can see in Exhibit 1 that if the exchange rate for converting yuan to dollars is controlled by the government of China at 8 yuan to $1, then the production cost is equivalent to $12.50. But if the exchange rate was allowed to be set by free market forces, it would be about 5 yuan to $1 and the production cost in China would be equivalent to $20. So a company that produces that doorknob for $18 in the USA is going to get driven out of the market and that factory in the USA is going to shut down or move to China. Conversely, if the yuan were to have an exchange rate based on market forces, U.S. companies would be competitive.

Exhibit 1

Brass Doorknobs

Assume production cost of 元 100
if made in China

@ exchange rate of 元 8 to $1
= $12.50

@ exchange rate of 元 5 to $1
= $20.00

In other words, the government of China manipulates its currency so that it subsidizes the cost of manufacturing in China.

The current and the former U.S. administration have refused to take any concrete actions against such manipulation by China and have chosen instead to jawbone. The problem with this approach is that currency manipulation by the Chinese Government is serving China's strategic best interests at the expense of U.S. manufacturing and employment.

The manipulation of its currency reduces the competitiveness of every other product, good and service in the world when compared to its production in China.

This form of protectionism by China is reaping huge rewards as its export-based economy is growing 3 or 4 times faster than the rest of the world with factories being built at a pace beyond the imagination of anyone just a few years ago. Meanwhile, factory jobs are disappearing in the USA and throughout the rest of the world. Even manufacturing plants in Mexico are moving to China.

But this is more than an economic battle.

Did you catch the statement by Congressman Tim Ryan of Ohio concerning the strategic paper ("Unrestricted Warfare") written by two Chinese military strategists? They suggested that military supremacy could be gained by undermining the manufacturing base of the United States by maintaining its currency at artificially low levels to gain an economic advantage for Chinese manufacturing and destroying the manufacturing base of the United States. Seems to be working, doesn't it?

The importance of a strong domestic manufacturing base to national security and national defense cannot be overstated.

Shortly after the Revolutionary War, the U.S. Government became concerned about the ability of the United States to respond to a second war with the British. Many scoffed at such a thought but were sadly mistaken when the War of 1812 erupted. Fortunately our forefathers had foresight. They knew that the USS CONSTITUTION would need copper sheathing to prevent barnacles from growing on its sides. Barnacles slow down ships and lead to time consuming maintenance on shore. So Paul Revere was offered a $10,000 U.S. Government loan to build a copper rolling mill. The loan was paid back when Paul Revere built the first copper rolling mill in the New World and rolled the copper sheets that were used to sheath the USS CONSTITUTION which prepared it for the War of 1812.

Personally, I admire the Chinese culture and believe that China does not need such a disruptive currency policy to compete in the world given its many other advantages. The Chinese economic policy is export driven by taxing its citizens through currency manipulation which takes away their disposable income. A market driven currency exchange rate policy would drive China's economy toward domestic consumption and a better life for its citizens.

But make no mistake about it, China is waging a mercantile war on the world and the world is sleeping.

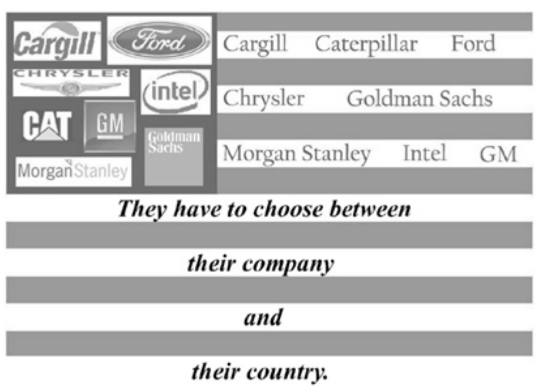
Why is the world sleeping? First, we must look at the role of the multinationals. Remember in the 1980s when Japan was such a fierce competitor in so many U.S. markets? The reaction by our largest corporations was loud and largely one voice calling for tariffs and restraints. Contrast that with today as most of the largest U.S. corporations are so much more international and especially with their investments in China. Many that do not have direct investments in China buy substantial numbers of components from China's factories. Many have set their strategic plans to produce components or products in China.

Today, many of the largest investment banking firms in the world are headquartered on Wall Street but derive half or more of their income from foreign sources. This ranges from managing the reinvestment of U.S. dollars flowing overseas to the construction of manufacturing facilities in China. Unquestionably, they have become beholden to the government of China.

It may surprise you to learn that I don't have a problem with any company that sets up or finances a plant offshore or imports components or products. But if manufacturing in America must compete with the protectionist policies of any foreign government . . . that is not fair. And if meaningful corrective action by the U.S. Government is thwarted by U.S. manufacturing and investment banking firms who gain from such protectionism . . . that is wrong. CEOs of multinational companies are put in a very difficult position when considering national trade policies.

They have to choose between their company and their country. (See Exhibit 2)

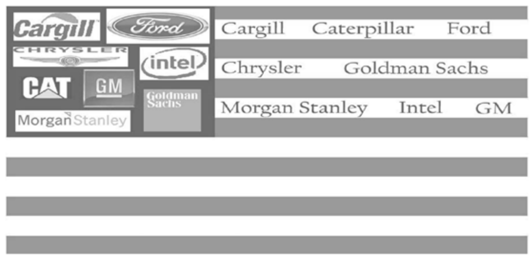
Exhibit 2



So who should America listen to for advice on tax and trade policy? (See Exhibit 3.) Obviously, none of the above . . . Let me explain. Earlier I mentioned that China practices a policy of managing its currency at artificially low levels to gain a 40 percent competitive advantage for any export products or services produced in China. Now, you must realize a simple truth, *a multinational corporation that manufactures in China and benefits significantly from this advantage doesn't want this to change.*

Exhibit 3

Who should America listen to for advice on tax and trade policy?



Obviously, none of the above…

At a 2006 meeting of an international economic policy committee of an association of manufacturing companies, one domestic manufacturing company said that it buys components from China and does not want the currency to change. Now there's a breath of honesty. Maybe not patriotic but at least he's honest.

Patriotic . . . why bring that word into the mix? Well, you see the strength of manufacturing is an inherent strength of our country. Some economists believe our country is in a transition from a manufacturing economy to a service economy just as it transitioned from an agricultural economy to a manufacturing economy years ago. But maybe the manufacturing economy was simply layered on top of our agricultural economy just as the service economy is layered on the manufacturing economy. And it is certainly hard to argue against the proposition that a weak manufacturing sector threatens our national security.

Sounds like our Nation needs some advice from the real world.

The measures that have not worked are jawboning the Chinese to change . . . you know, throwing adjectives and words at them 'til they stop. The multinationals have endless arguments for stretching out the process like. . . . "We don't want to start a trade war now, do we?" But *we are already in a trade war,* aren't we? Of course we are and we are losing. *We are pacifists in this war.* How about this one by the multinationals . . . *your* policies are protectionist! Yes, they actually say that, can you imagine? Blame the victim is frequently their approach. Often the accuser benefits from China's export subsidies which are clearly prohibited by the WTO as protectionist.

The irony is that domestic manufacturing companies are the victims of protectionism not the benefactors.

Another argument we hear is, "What about their fragile banking system?" This one has been around for years and of course, it is impossible to improve a banking system that depends on subsidies to such an extent without removing the subsidy, isn't it? Besides, their banks are owned by the same government that is holding almost a trillion U.S. dollars. Maybe their banks are not quite as insolvent as you have been lead to believe . . .

China's GNP has been growing about 10 percent a year since it established a new system to manage its currency about 2 years ago while the U.S. economy has been growing about 3 percent. This alone should have translated into an appreciation of the yuan against the dollar of at least 5 percent a year. Since this change, however, the government of China has allowed its yuan to appreciate only about 4 percent a year, thereby exacerbating the problem.

So, China has successfully continued to stonewall any real movement of its currency thanks, in part, to the support of some prominent multinationals and investment bankers.

That support is manifested in U.S. trade policy which is oriented to process rather than results. Multinationals and investment bankers are usually results oriented but not when it comes to China's currency manipulation. But then again, the delaying tactics are good results because this form of protectionism by China suits them just fine. At any rate, they are certainly beholden to the government of China. So their policy positions are in alignment with the policy of China.

There is no easy solution to this Chinese puzzle. Even I have supported the verbal approach . . . for years. Our nation could simply slap a tariff on all imports from China but I think we must take measured concrete steps with each one increasing in severity. The final step would be a tariff scheduled well in advance to force China to end its currency manipulation.

It is important to understand that the end of currency manipulation will not end the depreciation of the U.S. dollar against other currencies including China's yuan.

For this reason, it is difficult and perhaps impossible to develop a coherent trade policy to deal with China and the rest of the world without considering the tax policies of our own country. In addition to manipulating its currency, China and 138 other countries use Value Added Taxes (VATs). VATs discriminate in favor of domestic production of goods and services. (See Exhibit 4). The USA is the only major trading nation which does not use VATs to protect its domestic production of goods and services. (See Exhibit 5). VATs are a tax but they are also a form of tariffs which are legally exempt from WTO rules. VAT revenues are used to lower taxes on jobs and help fund government programs such as national health care.

Exhibit 4

Some Countries Using VAT Tax to Support Factory, Farm & Service Jobs

Australia	Finland	Japan	Russia
Austria	France	Korea	Singapore
Belgium	Germany	Luxembourg	Slovak Republic
Brazil	Greece	Mexico	Spain
Belgium	Hungary	Netherlands	Sweden
Canada	Iceland	New Zealand	Switzerland
China	India	Norway	Thailand
Czech Republic	Ireland	Poland	Turkey
Denmark	Italy	Portugal	United Kingdom

Notes: 139 countries have a border adjustable tax which discriminates in favor of domestic production of goods & services. One province in India boasts of a VAT tax over 50% in promoting itself as a prime location.

Exhibit 5

Countries Not

USA

How can a manufacturing facility in the USA compete with a similar facility in China or any other country if the U.S. facility must carry the burden of the health care cost of its workers and its foreign competitor does not?

One of Revere's largest remaining customers recently presented Revere with a cost comparison of sourcing centrifugal chillers from China versus the USA. Revere supplies copper strip for these chillers. Exhibit 6 shows how the costs would compare without the protectionist currency manipulation by China. Note that the total costs are about the same for both countries and indeed, if freight costs were added, the delivered cost to the USA of the chiller produced in China would be higher than the chiller produced in the USA. In Exhibit 7, the cost of the product from China is adjusted to reflect currency manipulation by China of 40 percent. As you can see in Exhibit 8, products from China also benefit from a 17 percent Chinese Government Value Added Tax or VAT rebate on export to the USA. This results in a price war that American factories cannot win.

Exhibit 6

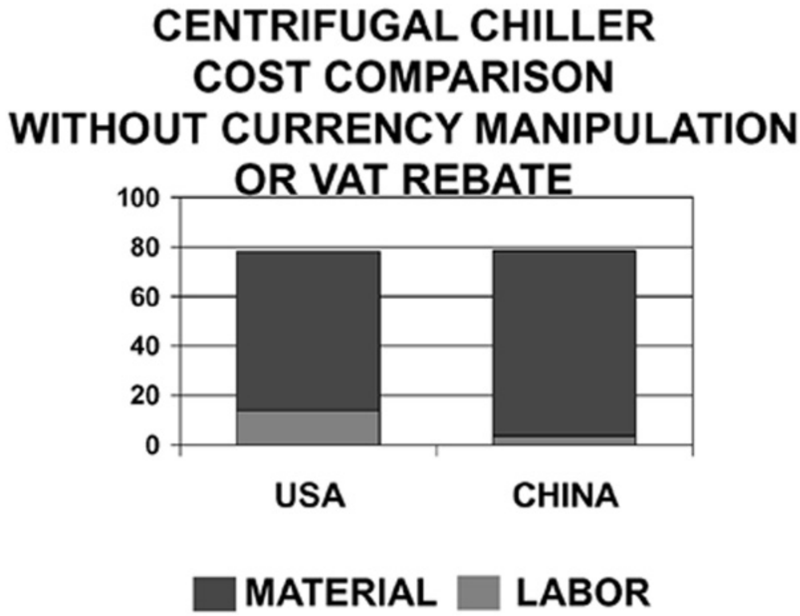


Exhibit 7

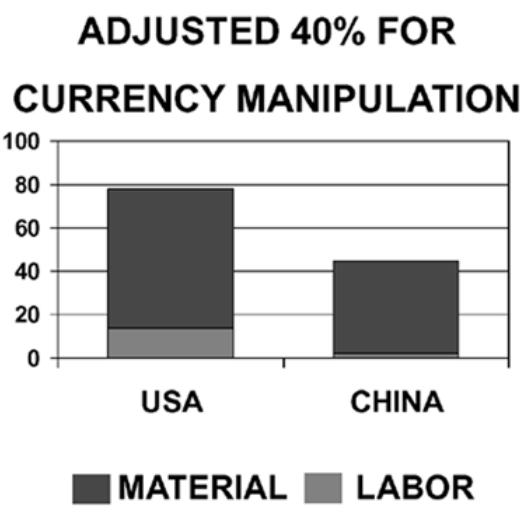
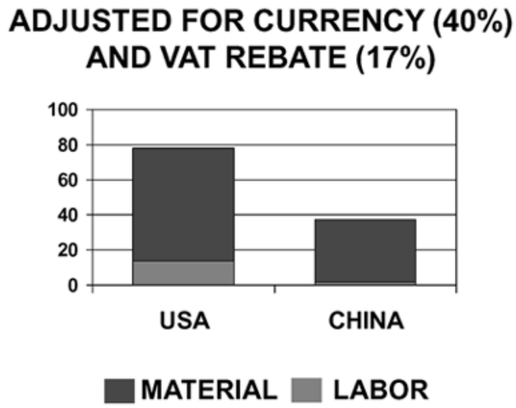


Exhibit 8



Of course, if the U.S. producer shipped any product to China, it would be hit with a 17 percent VAT on entry to China. China will use revenues from that VAT tax to fund weapons systems and provide health care benefits for its people. Just think about it, the U.S. factory worker produces a product that must bear the health care cost of the U.S. worker *and* the Chinese worker he competes against in order to export. Of course, some will argue that the American worker or management is to blame because the product made in the USA just can't compete because we are so inefficient.

Market determined exchange rates simply put all nations back at the starting gate for the race to determine who will win the battle to produce competitive goods and services assuming all other things are equal. Of course, all other things are not equal and because of this our Nation's inability to compete with China and the rest of the world simply means that our currency will continue to depreciate and the standard of living of all Americans will decline and our Nation will grow weaker.

The loss of manufacturing jobs to date in the USA is only the tip of the iceberg. The impact of currency manipulation, VAT taxes and health care costs are not limited to manufactured goods. Future losses will go far beyond the continued loss of manufacturing jobs and extend to the agriculture, food processing and service industries. Indeed, Alan Blinder, former Federal Reserve Vice Chairman, was quoted in *The Wall Street Journal* on March 28th saying that, ". . . as many as 40 million American jobs (are) at risk of being shipped out of the country in the next decade or two."

So, the looming question is, "What should be done to counter this offensive and protective behavior by China and other nations?"

The first step in the battle to offset currency manipulation should be to pass the Stabenow-Bunning-Bayh bill in the Senate and Ryan-Hunter bill in the House that would define currency manipulation as an illegal subsidy and allow the application of countervailing duties (CVDs) to offset the impact of the currency manipulation for companies that are being injured.

In addition, the remedies should not be contingent on Treasury Department approval. This is the same Treasury Department that does such a good job of representing its friends on Wall Street by consistently failing to cite China for manipulating its currency. Please lead Congress to represent Main Street not Wall Street and factory workers in the USA not China.

These bills are designed to be compliant with the rules of the WTO. That being said, if the WTO refuses for any reason to sanction the use of CVDs to offset currency manipulation, we must assume that the system that governs world trade is broken and must be fixed. Immediately! If the use of CVDs to offset currency manipulation does not lead China and other nations to stop manipulating their currency, then the USA must take increasingly stronger measures, even if it means stepping outside WTO rules.

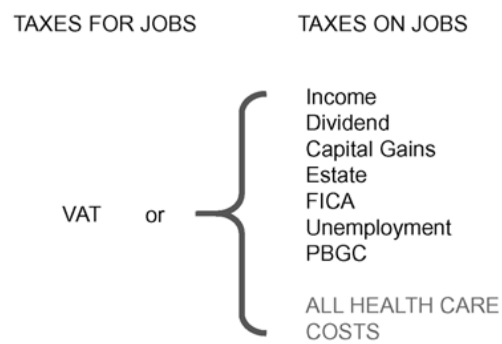
At the same time, the USA must reform its tax system and institute VATs on a scale that gives production of goods and services in the USA a competitive advantage.

If you are competing with somebody else, you just don't look at where they are. You try to figure out how to get ahead of them. That's pretty simple, but that is how you develop a winning strategy.

So the competitive objective should be to beat the competition, not simply match them.

In order to achieve this objective, the USA should eliminate all national taxes, both corporate and personal, including income, dividend, capital gain, estate, FICA and unemployment taxes as well as lifting the burden of health care costs off employers who provide jobs. (See Exhibit 9). A new national VAT system would replace these costs.

Exhibit 9



Notice these items are referred to as costs not revenues because one must look at them as a burden on jobs.

The new system should be designed to be revenue neutral for all classes. Adverse impacts on charitable and lending institutions need to be considered by matching charitable grants and providing housing subsidies which would help offset the regressive VAT system and make it fair. The regressive nature of a VAT system would be further offset by the provision of a national health care system funded by a VAT for the USA.

This step is critical to the health of manufacturing in the USA.

A national health care system similar to that employed by Great Britain has features that would appeal to Americans. It provides universal health care for all but allows any citizen to opt out to private care as long as they are willing to pay the cost. I am not aware of the citizens of any nation that are considering having their country adopt the system used in the USA which eats up twice as much GNP per capita and burdens the domestic production of goods and services to such an extent.

The lack of a VAT system in the USA allows European nations to gain market share from the USA partially offsetting the impact of China's manipulation of its currency on the production of goods and services in Europe. That's one reason why Europe is less vocal about China's mercantile war on the world.

When Paul Revere tried to rouse the countryside with his wake up call, what did the people do? They certainly didn't go back to sleep. Our nation is being destroyed by the international trade, tax and health care policies of our own country. We all need to wake up and listen. But we must be careful who we listen to . . .

Wake Up, America!

Senator DORGAN. Mr. O'Shaughnessy, thank you very much for your testimony.

Next we will hear from Scott Paul, the Executive Director of Alliance for American Manufacturing. Mr. Paul, you may proceed.

STATEMENT OF SCOTT N. PAUL, EXECUTIVE DIRECTOR, ALLIANCE FOR AMERICAN MANUFACTURING

Mr. PAUL. Senator Dorgan, Senator DeMint, thank you for the opportunity to testify this afternoon on our flawed trade relationship with China. First I'd like to briefly introduce you to the Alliance for American Manufacturing. We're a new public policy organization formed by some of America's leading manufacturers with their workers. We focus on issues like China. Our goal is singular in purpose. It's to strengthen American manufacturing and therefore our economic and national security.

Mr. Chairman, this debate, the debate on China, on trade, and on manufacturing, is portrayed by too many elites in a fundamentally flawed way. You're either an enlightened free trader or a jingoistic protectionist. Trade produces many winners and a few unfortunate, unskilled losers who must be retrained for the jobs of the future, or so the argument goes.

You'll hear assertions that our trade relationship with China is a no-brainer and a win-win. These labels are completely inaccurate. It's because our trade relationship with China is no longer a matter of philosophy, speculation, or forecasting, but rather one of cold hard facts. It's not anti-China or protectionist to insist that we hold China and other trade partners accountable for the commitments they made to gain access to the U.S. market. In fact, it is shameful for anyone to suggest that a blind eye be turned to market-distorting practices that are harming America's workers, businesses, farmers, and consumers.

Our trade deficit with China was a record $233 billion last year. It was responsible for a staggering 42 percent of the U.S. total non-oil trade deficit. China's exports to the United States were six times greater than American exports to China, as you have pointed out, which were $52 billion. In 2006 alone, we saw a dramatic surge of imports from China in nearly every category of goods. In steel the increase was more than 65 percent. In paper and wood products the increase was greater than 30 percent. Even in computer and electronic goods, the increase was more than 22 percent.

Every day we export more know-how, jobs, technology, and intellectual property to China than high-value-added products. Some of our fastest growing exports to China tend to be unprocessed commodities and waste, like scrap metal. This one-way trade relationship with China has simple yet devastating consequences: lost American jobs and a declining American manufacturing and innovation base. Our Nation has lost more than 3 million manufacturing jobs over the past 6 years. More than 40,000 manufacturing facilities have shut down, largely because of import competition or shifts of production abroad, but certainly not as a result of productivity.

A new study by the Economic Policy Institute helps illuminate the egregious impact of our lopsided trade relationship with China. The report, "Costly Trade With China," concludes that the trade deficit with China has displaced 1.8 million American jobs since China joined the WTO in 2001. Dr. Robert E. Scott, the report's author, found that jobs were displaced in every state as well as the District of Columbia and that nearly three-quarters of the job losses were in manufacturing industries.

The study is critical because it is one of the few that looks at the entire trade picture, that is both imports and exports, and their consequences for employment.

Due to our trade deficit with China, states like New Hampshire and North Carolina lost at least 2 percent of their overall employment, while California shed an estimated 269,300 jobs and South

Carolina an additional 29,900 jobs. In state after state the story is the same. The losses from opening up trade with China have far outweighed the gains for American workers and manufacturers.

What has gone wrong? Dr. Peter Navarro of the University of California at Irvine has documented the systematic undercutting of prices by China, which has allowed its producers to establish a dominant position in the manufacturing of many consumer goods as well as strategic materials. Professor Navarro estimates that lower labor costs, which include some labor market forces but also widespread artificial factors, including the nonenforcement of wage laws and migration restrictions, account for nearly 40 percent of the price advantage.

Export subsidies, which are illegal under the WTO, account for an additional 17 percent of the price advantage. Undervalued currency, the product of government manipulation, which is illegal under our trade laws, accounts for an additional 11 percent price advantage. Counterfeiting and piracy add 9 percent and lax labor, environmental, health and safety regulations contribute an additional 5 percent to the price advantage and have made product safety a key issue that must be addressed to safeguard American consumers.

It is well documented that China continues to follow a policy of export-led growth to buildup its own manufacturing base at the expense of other countries. Almost 60 percent of Chinese exports come not from Chinese firms, but from foreign-invested enterprises. Many of these multinational companies set up operations hoping to serve the Chinese market, only to face a web of policies and practices to limit the opportunities there, instead finding incentives to export back to the United States.

In industries ranging from telecommunications to steel to machinery and many others, China's leaders have made it clear that the state will continue to exert its control, making it virtually impossible for American firms to compete against massive governmental subsidies.

American company after company has been adversely affected by a Chinese government policy that simply needs to be described for what it is, cheating. China must be held accountable. It agreed to certain conditions when it joined the WTO, but time after time it has refused to grant the kind of access to its markets that we provide to it and it has engaged in unfair and predatory practices to increase its exports. Subsidies, dumping, currency manipulation, violation of labor rights, and lax or nonexistent environmental enforcement are just some of the egregious practices that must be addressed.

But that is only half the story. The inability and in many cases the unwillingness of the trade bureaucracy in Washington to enforce current trade laws with respect to China has allowed the deck to be stacked against U.S. manufacturers and workers. The rules of international trade are just that, rules, not suggestions. Unfortunately, they haven't been treated that way. Quite literally, these laws—and President Hoffa mentioned this as well—including our antidumping and countervailing duty laws—when enforced can level the playing field. These laws must be aggressively deployed and appropriately enhanced to ensure that our workers and firms have the opportunity to benefit in the global marketplace.

As the debate on China and trade policy continues this summer, I'd urge you not to lose sight of the stark reality that U.S. manufacturers and workers face when trade laws are not enforced. A study we released in May entitled "Enforcing the Rules" found that, for instance, from 2001 to 2003 American furniture manufacturers lost $333 million in revenue as a result of wooden bedroom furniture dumped into the U.S. market from China. Producers and workers in industries as diverse as steel, ball bearings, cement, shrimp, raspberries, semiconductors, and honey were all harmed by unfair and illegal foreign trade practices and lost billions upon billions of dollars.

The study concluded that there is a 50 to 1—that's 50 to 1—economic advantage to enforcing trade rules. The economic losses suffered by communities battered by unfair trade more than offset any minimal consumer gains that result from dumping products at below cost on the U.S. market.

The time is long overdue for the U.S. to enforce our trade laws and to hold China accountable for its unfair trade practices. It's time for trade officials to stand up for American workers and American manufacturers.

Mr. Chairman, we look forward to working with you to hold the Chinese government accountable for its unfair trade practices so that our workers and manufacturers will continue to have the opportunity to strengthen the American economy. Thanks for allowing me to testify today.

[The prepared statement of Mr. Paul follows:]

PREPARED STATEMENT OF SCOTT N. PAUL, EXECUTIVE DIRECTOR, ALLIANCE FOR AMERICAN MANUFACTURING

Mr. Chairman and distinguished Members of the Subcommittee, I commend you for taking the time to study America's trade relationship with China and thank you for inviting me to testify on behalf of the Alliance for American Manufacturing. I am honored to be before this Subcommittee to discuss an issue of such importance to our economy and our national security.

First, I would like to introduce the Alliance for American Manufacturing (AAM) and our perspective on this topic. We are a new partnership formed by some of America's leading manufacturers and their workers to explore challenging public policy topics such as trade, health care, retirement, energy, currency valuation, and other issues of mutual concern. AAM works in a cooperative, non-partisan way, bringing together labor and management, Democrats, Republicans and independents, to work for one goal: strengthening American manufacturing and therefore bolstering our Nation's economic and national security. Our mission is to provide policymakers like you with useful analysis of the issues, as well as innovative policy ideas to move us toward effective solutions.

With respect to trade and currency, conscious policy choices and crimes of omission—like the unwillingness of our trade bureaucracy and the World Trade Organization (WTO) to enforce the rules of trade or to apply new ones that were never negotiated—are damaging U.S. workers and businesses in every state in the Nation. Our nation has lost more than 3.2 million manufacturing jobs over the past 6 years. More than 40,000 manufacturing facilities have shut down nationwide; our annual trade deficit stands at more than $764 billion.

The largest single source of our trade woes is China. China's trade surplus was responsible for a staggering 42 percent of the United States' total, non-oil trade deficit last year. Our trade deficit with China skyrocketed for the sixth consecutive year in 2006, reaching a record high of nearly $233 billion. China's exports to the United States were six times greater than American exports to China, which were only $52 billion.

In just the past year, we have seen a dramatic surge of imports from China in nearly every category of goods. In steel, the increase is more than 65 percent; in paper and wood products, greater than 30 percent; and in computers and electronic goods, over 22 percent. Every day, we export more "know-how," jobs, technology and intellectual property to China than high-value added products, which we depend on for good jobs and strong economic growth. Some of our fastest-growing exports to China tend to be unprocessed commodities and waste like scrap metal. The truth is, if you removed the names of the countries and looked only at the underlying trade data, you might assume that the United States was the low-cost, industrializing economy and China was the powerful economic engine.

The consequences of illegal trade practices to American manufacturers and workers are severe. For example, research conducted for AAM found that from 2001 to 2003 American furniture manufacturers lost $333 million in revenue as a result of wooden bedroom furniture being dumped into the U.S. market from China.

A new study by the Economic Policy Institute helps illuminate the egregious impact of this lopsided trade relationship. The report, "Costly Trade with China," concludes that the trade deficit with China has displaced 1.8 million American jobs since China joined the WTO in 2001. Dr. Robert E. Scott, the report's author, found that jobs were displaced in every state and the District of Columbia, and nearly three-quarters of those jobs were in manufacturing industries. The study is important because it is one of the few that looks at the entire trade picture. It estimates the labor that would be required to produce a given volume of exports, and the labor that is displaced when a given volume of imports is substituted for domestic output. The job losses in the study represent an estimate of what employment levels would have been in the absence of our growing trade deficit with China.

Due to our trade deficit with China, New Hampshire and North Carolina have lost at least 2 percent of their states' employment while California shed an estimated 269,300 jobs. In state after state, the story is the same: there may be scattered success stories of exporting to China, but trade can both create and destroy jobs, and the losses from opening up trade with China have far outweighed the gains for American workers and manufacturers.

The flood of subsidized imports from China, aided by currency manipulation by the Chinese government, has denied American workers the opportunity to continue their own manufacturing careers, and has denied their children the opportunity for a future career in manufacturing of their own. While many of these workers are able to find new jobs, more than one-third of workers displaced from manufacturing do not. Workers who have lost their manufacturing jobs due to international trade are able to find employment only in lower-paying industries, often without many of the health and retirement benefits offered by manufacturing.

In industries as diverse as agriculture, computer chips and other high-tech goods, strategic materials, steel, and many, many others, American businesses and workers—who are highly productive and efficient—are facing a torrent of subsidized products made by workers in China who are paid artificially low wages in deplorable conditions. There is nothing free about that sort of trade. American workers and businesses need rules that are fair to everyone, and they need those rules enforced.

The sheer size and structural nature of this trade deficit with China raises serious questions about its causes, including to what extent the deficit is driven by Chinese government interventions in its own economy. In particular, China maintains numerous policies including state-sponsored subsidies aimed at promoting investment, exports and employment. Those policies have a direct role in increasing the U.S.-China trade imbalance and negatively affect the well-being of our domestically-based manufacturers, service providers and farmers.

Dr. Peter Navarro of the University of California at Irvine has documented the systematic undercutting of prices by China, which has allowed its producers to establish a dominant position in the manufacturing of many consumer goods and some strategic materials. Professor Navarro estimates that lower labor costs, which include legitimate labor market factors as well as widespread artificial factors including non-enforcement of wage laws and migration restrictions—account for nearly 40 percent of the advantage. Export subsidies—illegal under the WTO—account for 17 percent. Undervalued currency, the product of government manipulation illegal under trade laws—accounts for an additional 11 percent. Counterfeiting and piracy add 9 percent and lax environmental, health and safety regulations contribute an additional 5 percent.

Is this the free market at work? Of course not. It is a deliberate strategy on the part of China's government to grow its economy, providing incentive for many of the world's manufacturers to shift their production to China. When China became a member of the WTO, proponents argued just the opposite: that it would herald in a new age of opportunity and expand market opportunities for American companies. Unfortunately, China continues to follow a policy of export-led growth to build up its own manufacturing base at the expense of other countries. Almost 60 percent of China's exports come not from Chinese firms, but from foreign-invested enterprises. Many of these companies set up operations hoping to serve the Chinese market, only to face a web of policies and practices to limit their opportunities there, instead finding incentives to export their products back to their home countries or other markets.

Just a few months ago, the director of the Chinese Government's State-owned Assets Supervision and Administration Commission (SASAC), announced a new policy that raises serious questions of governmental control, involvement and intervention in a number of major industries. In industries ranging from telecommunications to steel to machinery and many others, China's leaders have made it clear that the state will continue to exert its control, making it virtually impossible for American firms to compete.

China also has provided massive subsidies to its companies to give them an advantage over our farmers, workers and businesses trying to sell their products to China, at the same time China is flooding our market with its products. American company after American company has been adversely affected by a Chinese government policy that simply needs to be described for what it is: cheating.

China needs to be held accountable. It agreed to certain conditions when it joined the WTO but, time after time, it has refused to grant the kind of trade access to its markets that we provide to it and it has engaged in unfair and predatory practices to increase its exports. The result is one way free trade and, as noted above, skyrocketing trade deficits. Subsidies, dumping, currency manipulation, violation of labor rights, and lax or nonexistent environmental enforcement are just some of the egregious practices that must be addressed.

It is regrettable that the choices on trade with China are often presented to you as absolutes: you are an enlightened "free trader" who wants to engage China, or you are a jingoistic "protectionist" who seeks to shore up unproductive industries. These labels are not helpful and they are not accurate. In fact, they needlessly cloud the debate on China. America is demanding action on China; the calls for a Congressional response are coming from Red States and Blue States, from groups who have supported free trade agreements, as well as those who have opposed them, and from Senators and Representatives who supported permanent Normal Trade Relations with China, as well as those who opposed it. Our trade relationship with China is no longer a matter of philosophy, speculation and forecasting, but rather one of cold, hard facts.

In an era when we expect increased accountability from our own government, it is disgraceful for anyone to suggest that a blind eye should be turned to international trade violations that are contributing to an enormous loss of American jobs and income. Now, as the Congress is considering measures to strengthen trade enforcement, is the perfect time for Congressional consideration of appropriate interventions.

To ensure that American manufacturers and workers have the same opportunity as their competitors in the global marketplace, Congress must exercise the responsibility given to it under Article 1, Section 8 of the Constitution, and ensure that international commerce is appropriately regulated. The Alliance for American Manufacturing commends the Chairman and the Subcommittee for being at the forefront of these efforts.

Congress and the Administration have some tools already at their disposal to ensure that businesses operating in the United States and in China have the same opportunity to compete. Quite literally, our trade laws—including anti-dumping and countervailing duty laws—when enforced, level the playing field and allow individual companies, farms and even whole industries in America to remain competitive. We believe those trade laws should be steadfastly maintained, appropriately strengthened, and aggressively deployed.

Some critics argue, however, that these trade laws are shortsighted in this era of globalization and that the end results of these laws are limits on consumer choice and thus higher prices. When China's illegal practices have been challenged, alarm bells have been rung by those who fear escalation into a "trade war" whose victims will be American consumers.

Those fears are unfounded.

The Alliance for American Manufacturing's "Enforcing the Rules" study concludes that when our trade laws are enforced, our workers, communities and businesses are able to contribute 50 times more to the economy than any resulting increase in consumer prices.

The reality is that enforcing the law works. Imposing clear and direct penalties on China for illegal activities is vital to ensuring that we all have the same opportunity to benefit in the global economy. The rules of international trade are just that—rules, not suggestions. The time is long overdue for the United States to enforce our trade laws and hold China accountable for its unfair trading practices. It is time to stand up for American workers and American manufacturers. Americans should expect—and deserve—nothing less.

The continued inability and sometimes the unwillingness of policymakers in Washington to enforce current trade laws have allowed the deck to be stacked against American manufacturers and workers in too many cases. The Chinese government is clearly violating scores of its WTO commitments without facing any real consequences in most cases. As a result, our manufacturers are often forced to play by a different set of rules than their competitors.

The Commerce Department has correctly allowed countervailing duty laws to be applied to non-market economies such as China, which may lead to some relief for American paper producers who have been devastated by illegal subsidies. The Administration has initiated dialogues with China on steel and currency and cases at the WTO on some Chinese subsidies and its theft of some intellectual property. These are important and significant first steps, but the size and scope of the issues I have mentioned demonstrates the urgent need to do more.

Every nation in the world faces similar challenges from China, but nearly all of our industrialized competitors have managed to maintain an overall balanced current account. Germany, Japan, Korea, Brazil and other industrialized nations understand the importance of a strong and growing manufacturing base. So should we, before it is too late.

Manufacturing has been the engine that drives the American economy for more than a hundred years, and it will continue to be well into the 21st Century.

Manufacturing in the United States generates about $1.4 trillion, or 12 percent of our gross domestic product.

Manufacturing is responsible for nearly two-thirds of private sector research and development in the United States. Nearly 80 percent of all patents filed in the United States originate in the manufacturing sector.

Over the past two decades, manufacturing productivity has increased at twice the rate of the rest of the private sector.

Manufacturing is a vital part of the economies of most states. As a share of gross state product (GSP), manufacturing in 2001 was among the three largest private-industry sectors in all but ten states and the District of Columbia. Manufacturing is the largest sector in ten states and in the Midwest region as a whole. It is the second largest in nine states and the third largest in 21 others.

Manufacturing directly employs 14 million Americans and supports eight million more. Each manufacturing job supports anywhere between four and seven other jobs, providing a boost to local economies. For example, every 100 steel or every 100 auto jobs create as many as 700 new jobs in the rest of the economy. This contrasts with the retail sector, where every 100 jobs generate 94 new jobs elsewhere, and the personal and service sectors, where 100 jobs create 147 new jobs. This multiplier effect reflects how manufacturing's linkages run deep into the economy, providing the means that translate improvements in manufacturing productivity to the economy as a whole.

We depend on domestic manufacturing to supply our advanced materials for equipment like the Joint Strike Fighter, the Bradley Fighting Vehicle, the Abrams Tank, and our naval fleet. If we continue to lose our manufacturing base, our Nation's military could lose its primary source of strategic resources, and we as a nation would become dangerously dependent upon foreign sources of supply.

The Congress and the American people have become all too aware of the limitations that dependency on foreign sources of energy creates for foreign policy and national security purposes; it makes no sense to exacerbate that problem by depending on China and other nations to supply our critical defense needs. Just as our Nation is seeking to achieve energy independence from the Middle East, we also should avoid becoming more dependent on others to supply our national and homeland defense needs.

Our Nation's flawed trade relationship with China unquestionably contributes to the anxiety and uncertainty many Americans feel about their jobs, their future, and perhaps most importantly for them, their children's future. An effective and meaningful change in trade policy with China can make a difference to the American people in the following ways:

- Whether tomorrow brings the layoff notice or the productivity bonus;

- Whether their community has a top-notch public school, or one that is struggling to keep it doors open because the town's factory—its largest source of tax revenue—shut down and shifted production to the People's Republic of China;
- Whether the jobs of the future for their children will be flipping burgers or careers in nanotechnology and advanced manufacturing; and
- Whether their nation will have an industrial base that can supply the critical materials that allow us to defend our nation, or if we will be forced to depend on the goodwill of other nations to do that for us.

AAM believes that America's leadership in the information age does not mean that we have to accept defeat when it comes to manufacturing and our trade relationship with China. On the contrary, the nation that has the ideas and innovation, as well as cutting-edge technology and manufacturing, is the nation that will win the global economic battles of the future. That is why we look forward to working with you to ensure that our nation puts into place policies that will allow manufacturing to thrive well into the 21st century. America's future growth, security and leadership in the global economy will depend on the strength and viability of our manufacturing base.

Contrary to popular misconceptions, the industrial age is not over. In fact, just the opposite is true. From nanotechnology and robotics to lasers and biotechnology, we are on the cusp of incredible advances in manufacturing. America must be the nation that leads the world into the next stages of development. Manufacturing is, and will continue to be, an integral part of the "new economy." With manufacturing, the new economy will thrive. Without manufacturing, much of this new economy would not even exist. Federal Reserve Chairman Ben Bernanke recognized this fact on February 28 when he said, "Our economy needs machines and new factories and new buildings and so forth in order for us to have a strong and growing economy."

Mr. Chairman and Members of the Subcommittee, we respectfully urge you to enforce our trade laws and hold China accountable for its unfair trade practices so that our workers and manufacturers will continue to have the opportunity to strengthen the American economy. Thank you again for the opportunity to testify today. I am happy to answer any questions you may have.

Senator DORGAN. Mr. Paul, thank you very much.

Finally, we will hear from Robert Nichols, who is President and Chief Operating Officer of the Financial Services Forum. Mr. Nichols, welcome. You may proceed.

STATEMENT OF ROBERT S. NICHOLS, PRESIDENT AND COO, THE FINANCIAL SERVICES FORUM

Mr. NICHOLS. Thank you. Chairman Dorgan and Ranking Member DeMint, thanks for the opportunity to participate in this important hearing. I appreciate your leadership and attention to these timely issues.

The emergence of China will not only be one of the notable economic stories of the 21st century, but one of the more significant events in economic history, with profound implications for U.S. economic growth and job creation. Given the reality of China's continued emergence, the task before Congress and other key U.S. policymakers is to ensure that America participates constructively in China's development so that this event takes place on terms that work for America, our producers, our workers, and our consumers.

The Financial Services Forum is strongly of the view that a more open, competitive and effective Chinese financial sector is a prerequisite if China is to achieve its own economic goals, but, more importantly, if the issues that have complicated the U.S.-China economic relationship, particularly the need for further currency reform and the trade imbalance, are to be successfully addressed. Thus my comments today will focus on the importance of market access and the benefits that market access of U.S. financial services firms will bring here to America.

Mr. Chairman, the rate of China's expansion and the impact of its integration into the global trading system are quite singular in the history of the world's economy. A couple of data points to underscore that observation. One, their economy has grown at an average annual rate of better than 9 percent for the last 2 decades. As recently as 1999, China was the world's seventh largest economy. Senator DeMint, as you noted, it is now the world's fourth largest, likely to overtake Germany as the third largest perhaps later this year. If their growth rate is maintained, China could pass Japan as the world's second largest economy by 2020. And of course, today the U.S. and China already account for half the world's economic growth.

Additionally, since China joined the WTO in 2001 trade between the U.S. and China has nearly tripled. Exports to China have grown at roughly five times the pace of U.S. exports to the rest of the world and China has risen from our ninth largest export market to our fourth largest.

China's continued economic development is important for the U.S. economy in that a growing, more diversified Chinese economy that emphasizes a more active Chinese consumer is more stable, less dependent on exports, more in keeping with China's responsibilities in the global trading system, and, tremendously important, as an ever-expanding market for American-made products and services.

But if China's economy is to continue growing and diversifying and in doing so serving as an ever-increasing source of U.S. economic growth and job creation, it needs a more open, modern, and effective financial system. Unfortunately, Mr. Chairman, at present China's non-modern and ineffective financial system represents perhaps the greatest threat to their continued development.

I'll expand a little more on the point I noted earlier, namely that a more effective and efficient financial sector in China lays the groundwork to successfully addressing the issues that have complicated and provided significant friction in the U.S.-China economic relationship, chief among them the need for further currency reform and meaningfully reducing the trade imbalance.

Regarding the currency, Chinese authorities have repeatedly argued that an immediate shift to a fully market-determined yuan is very difficult, given the underdeveloped state of their capital markets. More specifically, Chinese banks, securities firms, and other businesses lack the expertise to develop and trade derivatives and other structured instruments used to hedge the risk associated with greater currency volatility. Sophisticated derivative products and hedging techniques provided by foreign financial services firms would clearly diminish such concerns.

Turning to the trade deficit, reorienting the financial habits of China's population to achieve a better balance between savings and consumption while progressively bringing more than a billion Chinese into the global economy, which is roughly a fifth of the world's population which is not participating in the global economy, in our view is the most powerful remedy for the U.S.-China trade imbalance.

Chinese households, Mr. Chairman, historically save from a third to as much as half of their income, as compared to the single digit savings rates here in the U.S. and in Europe. This pronounced propensity to save is related to the declining role of the state and the fact that most Chinese depend on their families and private savings to pay for retirement, health care, and the economic consequences of accidents or disasters.

Activating the Chinese consumer requires the availability of financial products and services that we in this room take for granted: personal loans, credit cards, mortgages, 401K's, pensions, and life, property, health insurance products that will eliminate the need for such precautionary savings and facilitate consumption. We want to get into that market to provide those.

Mr. Chairman, the fastest way for China to develop the modern financial system it needs to achieve more sustainable economic growth, allow for a more flexible currency, and increase consumer consumption is to import it, that is by opening its financial sector to greater participation by foreign financial services firms. By providing the financial products and services that China's citizens and businesses need to save, invest, insure against risk, raise standards of living and consume at higher levels, foreign financial institutions, including U.S. providers, would help create what every U.S. manufacturer, exporter, and service provider wants—a China that is less dependent on exports, more consumption-driven, and therefore an enormously important and ever-expanding market for American products and services.

Thank you very much for the opportunity to testify.

[The prepared statement of Mr. Nichols follows:]

PREPARED STATEMENT OF ROBERT S. NICHOLS, PRESIDENT AND COO, THE FINANCIAL SERVICES FORUM

Introduction

Chairman Dorgan and Ranking Member DeMint, thank you for the opportunity to participate in this important hearing on the impact of U.S.-China trade relations on American manufacturers, consumers, and workers. The emergence of China will not only be one of the great economic stories of the 21st century, but one of the most significant events in economic history. The integration of a fifth of the world's population into the global economy—not overnight, but over time—has truly profound implications for U.S. economic growth and job creation. Given the reality and inevitability of China's continued emergence, the task before Congress and other U.S. policymakers is to ensure that America participates constructively in China's development, and in ways that work for American producers, workers, and consumers.

I am here as President and Chief Operating Officer of the Financial Services Forum. The Forum is an association comprising the Chief Executive Officers of 20 of the largest and most diversified financial institutions with business operations in the United States. The Forum works to promote policies that enhance savings and investment and that ensure an open, competitive, and sound global financial services marketplace. As a group, the Forum's member institutions employ more than 1.5 million people and hold combined assets of more than $12 trillion.

In addition to our other activities, the Forum is also the chairing organization of the *ENGAGE CHINA* coalition—a partnership among eight financial services trade associations united in our view that active engagement with China remains the most constructive means of ensuring that our two nations mutually benefit from our growing economic relationship.[1] More specifically, the coalition is strongly of the view that a more open, competitive, and effective Chinese financial sector is a prerequisite if China is to achieve its own economic goals, and if the issues that have complicated the U.S.-China economic relationship—particularly further currency re-

[1] American Bankers Association, American Council of Life Insurers, American Insurance Association, The Council of Insurance Agents & Brokers, The Financial Services Forum, The Financial Services Roundtable, Investment Company Institute, and the Securities Industry and Financial Markets Association.

form and the trade imbalance—are to be satisfactorily addressed. I'll have more to say on this topic in a few moments.

Importance of China to the Global and U.S. Economies

The 20 member CEOs of the Financial Services Forum meet twice a year, our most recent meeting occurring this past April. At each meeting, we conduct a survey regarding our members' outlook on the U.S. and global economies. As part of the survey, we ask our CEOs to rate a number of factors, including technological innovation, improved education, freer and more open trade, and growth in a number of regions around the world, to reflect their likely contribution to global economic growth over the next decade. Our CEOs have consistently rated China as the single most important source of growth for the global economy.

Mr. Chairman, the rate of China's expansion and the impact of its integration into the global trading system are unprecedented in the history of the world's economy. As recently as 1999, China was the world's 7th largest economy. China is now the world's 4th largest economy and will likely overtake Germany as the 3rd largest later this year.[2] Government figures released last week showed that China's economy expanded at an annualized rate of 11.5 percent in the first half of 2007, its fastest rate of growth since 1994. China has grown at an average annual rate of better than 9 percent for two decades. If such growth is maintained, China could surpass Japan as the world's second largest economy by 2020.[3] Together, the United States and China already account for half of the world's economic growth.

China's emergence is also stimulating growth and job creation in the United States. Since China's joined the World Trade Organization (WTO) in December of 2001, trade between the United States and China has nearly tripled, exports to China have grown at five times the pace of U.S. exports to the rest of the world, and China has risen from our 9th largest export market to our 4th largest.

It's important to point out that as staggering as these figures are, they represent only the beginning of China's eventual impact. Nearly all of China's economic activity is currently centered in the large, industrialized cities of China's eastern coast, and involves only about 35 percent of China's 1.3 billion people. More than 800 million people in China's central and western interior—an eighth of the world's population—are poor subsistence farmers, completely unengaged in the global economy. Even the 500 million people who live in China's eastern cities, produce its manufactured goods, and comprise China's rapidly growing middle and affluent classes have so far had a somewhat muted impact on the global economy.

This is because Chinese households historically save anywhere from a third to as much as half of their income, as compared to single-digit savings rates in the United States and Europe. This pronounced propensity to save is related to the declining role of the state and the fact that most Chinese do not have access to the financial products and services that we take for granted—mortgages, 401ks, pensions, credit cards, and life, property, and health insurance products—that would help them save, borrow, invest, insure against risk, and, therefore, consume at higher levels.

If China's economy continues to grow and diversify, and if greater availability to a wider range of modern financial products and services helps to eliminate the need for such "precautionary savings," China's 1.3 billion potential consumers will begin to consume at more normal levels, with profound implications for global economic growth and job creation, as the following comparison demonstrates:

Last year, the United States exported to Japan goods and services worth $60 billion—approximately the same amount exported to China ($55 billion). But China's population of 1.3 billion is *ten times* Japan's population of 127 million. In per capita terms, therefore, China consumed one-tenth the amount of American goods and services as Japan. If China's citizens were to eventually consume American-made goods and services at the same rate that Japan's citizens did last year, the United States would export more than $600 billion worth of goods and services to China, 11 times what America exported to China last year, an amount equivalent to 5 percent of America's GDP, and more than twice what we imported from China last year—replacing the trade deficit with a significant surplus.

China's Growth has Created Challenges—for China and the United States

Despite China's remarkable economic development over the last 25 years, the structure and pace of its economic growth has produced significant problems, both economic and social. The country's fixed investment- and export-driven develop-

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[2] See "China Growth Revs Faster, Escalating Policy Pressure," *The Wall Street Journal,* July 20, 2007.

[3] See "China's GDP Poised to Top Germany's as Power Shift Speeds Up," *The Wall Street Journal*, July 16, 2007.

ment—more factories to produce more goods for world markets—has left China vulnerable to economic slowdown elsewhere in the world (particularly in the United States), and to rising energy, materials, and labor costs. The manufacturing and export focus of the economy has also led to widening disparities between rich and poor, made worse by the closing or privatization of state-owned enterprises, which had provided most healthcare services in China. There are, in effect, two Chinas—a wealthy elite and a developing middle class along the coast, and the 800 million poor in the central and western interior.[4] The worsening wealth gap and the resulting social dichotomy have led to increasing political instability. Reports indicate that as many as 100 significant incidents of protest occur in China every day.

Almost immediately after assuming leadership at the 16th Chinese Communist Party Congress in 2002, President Hu Jintao and Premier Wen Jiabao sought to distinguish themselves as the "putting-people-first administration." They also articulated the notion of a "scientific viewpoint of development," by which economic growth is to be balanced with social priorities such as a more equitable distribution of income, poverty reduction, education, improved medical care, and environmental protection.[5] Such adjustments were necessary, according to the new leadership, to establish a more sustainable course for China's long-term economic growth and to achieve a more "harmonious"—which is to say, a more equitable and stable—society.

These priorities became the framework of China's 11th Five-Year Plan,[6] which broadens China's development policy beyond simply promoting rapid economic growth to include a clear emphasis on "common prosperity"—that is, an effort to extend westward the economic gains enjoyed principally in China's east coast urban areas. The Five-Year Plan seeks to address the twin problems of an economy perceived as being too dependent on external demand and the social consequences of the widening wealth gap by: (1) maintaining high rates of growth and job creation; (2) encouraging a structural shift from industry to services; (3) promoting the development of domestic consumer demand; (4) reducing poverty; and, (5) ensuring a more equitable distribution of opportunity and prosperity.

It is important to note that each of these goals is utterly aligned and consistent with the interests of the U.S. economy and working Americans. A growing, more diversified Chinese economy that emphasizes a more active Chinese consumer is more stable, less dependent on exports, more in keeping with China's responsibilities in the global trading system, and an enormously important and ever expanding market for American-made products and services.

But if China is to achieve these ambitious economic goals—and, in doing so, serve as an ever-increasing source of U.S. economic growth and job creation—it needs an open, modern, and effective financial system. Unfortunately, Mr. Chairman, at present, China's primitive and ineffective financial system represents perhaps the greatest threat to the continued growth and diversification of the Chinese economy.

Critical Importance of Financial Sector Reform in China

Capital is the lifeblood of any economy's strength and well-being, enabling the investment, research, and risk-taking that fuels competition, innovation, productivity, and prosperity. The financial system can be thought of as an economy's cardiovascular system—the institutional and technological infrastructure for the mobilization and allocation of the economy's lifeblood, investment capital.

As a financial sector becomes more developed and sophisticated, capital formation becomes more effective, efficient, and diverse, broadening the availability of investment capital and lowering costs. A more developed and sophisticated financial sector also increases the means and expertise for mitigating risk—from derivatives instruments used by businesses to avoid price and interest rate risks, to insurance products that help mitigate the risk of accidents and natural disasters. Finally, the depth and flexibility of the financial sector is critical to the broader economy's resilience—its ability to weather, absorb, and move beyond the inevitable difficulties and adjustments experienced by any dynamic economy. For all these reasons, an effective, efficient, and sophisticated financial sector is the essential basis upon which the growth and vitality of all other sectors of the economy depend. It is the "force

[4] According to an unpublished report by the World Bank that has been shared with the Chinese government, from 2001 to 2003, as China's economy expanded by nearly 10 percent a year, average incomes of the poorest 10 percent of Chinese households fell by 2.5 percent. See "In China, Growth at Whose Cost," *The Wall Street Journal,* November 22, 2006.

[5] See Wen Jiabao, closing speech at the Specialized Research Course for Province-Level Cadres on "Establishing and Implementing a Scientific Developmentalist Viewpoint," February 21, 2004.

[6] The Five-Year Plan, the 11th since 1953, was approved by the fifth plenary session of the 16th Communist Party Central Committee in October of 2005 and ratified by the National People's Congress this past spring.

multiplier" for progress and development, amplifying and extending the underlying strengths of a growing economy.

Given the unique and critical role an effective and efficient financial sector plays in any economy, reform of China's financial sector is a *prerequisite* to China achieving its own economic goals. Financial sector reform is also a prerequisite to meaningfully addressing issues that have complicated the U.S.-China economic relationship, particularly greater currency flexibility and reducing trade imbalances.

Achieving China's Economic Priorities

- *Maintaining High Rates of Growth and Job Creation:* Maintaining exceptional rates of economic growth and job creation in China increasingly depends on an effective system for mobilizing investment capital. At present, China's weak banking system intermediates nearly 75 percent of the economy's total capital, compared to about half in other emerging economies and less than 20 percent in developed economies. Despite some improvements in recent years, Chinese banks' credit analysis, loan pricing, risk management, internal controls, and corporate governance practices remain inadequate. Meanwhile, China's equity and bond markets are among the smallest and least developed in the world. More fully developed capital markets would provide healthy competition to Chinese banks and facilitate the development and growth of alternative retail savings products such as mutual funds, pensions, and life insurance products. And by broadening the range of funding alternatives for emerging companies, more developed capital markets would greatly enhance the flexibility and, therefore, the stability of the Chinese economy.
- *Shifting from a Manufacturing-for-Export to a Services-Based Economy:* Facilitating China's desired transition to a more services-based economy will require that competitively priced capital and credit be channeled to the most promising emerging service businesses, and that the array of financial products and services emerging businesses require—loans, letters of credit, accounts management services, asset management, and insurance products—be made available.
- *Activating the Chinese Consumer:* Activating the Chinese consumer requires the availability of financial products and services—personal loans, credit cards, mortgages, pensions, insurance products, and insurance intermediary services—that will eliminate the need for such "precautionary savings" and facilitate consumption.

In sum, a more modern, open, and competitive financial system would greatly enhance the productive capacity and stability of the Chinese economy and facilitate the achievement of China's economic goals, as described in the 11th Five-Year Plan. Indeed, research conducted by McKinsey indicates that genuine reform of its financial system would expand China's economic output by as much as 17 percent, or an additional $320 billion a year.[7]

Addressing Issues with the United States

A more effective and efficient financial sector in China is also a prerequisite to successfully addressing issues that have complicated the U.S.-China economic relationship, particularly further currency reform and meaningfully reducing the trade imbalance.

- *Market-determined exchange rate:* As Chinese authorities have repeatedly argued—reasoning generally acknowledged by most foreign analysts—that a more rapid shift to a market-determined yuan is not possible given the underdeveloped state of China's capital markets. More specifically, China's banks, securities firms, and other businesses lack the expertise to develop and trade derivatives and other structured instruments used to hedge the risk associated with greater currency volatility. Sophisticated derivative products and hedging techniques provided by foreign financial services firms would clearly diminish such concerns.
- *Reduction of trade deficit:* Reorienting the financial habits of China's population from precautionary savings to a better balance between savings and consumption—while progressively bringing more than a billion Chinese into the global economy—is the most powerful remedy to the U.S.-China trade imbalance.

[7] See "Putting China's Capital to Work: The Value of Financial System Reform," by Diana Farrell, Susan Lund, and Fabrice Morin, The McKinsey Global Institute, May 2006.

Status of Financial Sector Reform in China

In addition to working to meet its WTO commitments, China has also taken important steps to liberalize its financial sector and improve financial regulation. For example:

- The financial sector has been transformed from a single-bank system to a more diversified system with a central bank—the People's Bank of China—at the helm.
- Meaningful steps have been taken to eliminate state-directed policy lending, and amendments to the Law on Commercial Banks and the Law on the People's Bank of China have laid the foundations for commercially viable lending.
- The China Banking Regulatory Commission (CBRC) was established in April of 2003 to oversee all banks in China, investigate illegal banking operations, and punish violations of law.
- Interbank, equity, and foreign exchange markets have been established and important progress made toward implementing monetary policy through market mechanisms rather than by government fiat.

Despite these achievements, China's financial sector still faces serious challenges:

- Non-commercial lending to state-owned enterprises continues, although on a diminishing scale.
- The stock of nonperforming loans on banks' balance sheets remains high.
- Banks are undercapitalized and lending practices, risk management techniques, new product development, internal controls, and corporate governance practices remain inadequate.
- Prudential supervision and regulation of the financial sector is opaque, applied inconsistently, and lags behind international best practices.
- China's equity and bond markets remain small and underdeveloped.

With these problems in mind, efforts to build on the progress achieved to date should focus on:

- The critical importance of open commercial banking, securities, insurance, pension, and asset management markets to promoting the consumption-led economic growth that China's leaders seek;
- The clear benefits to China of increased market access for foreign financial services firms—namely the introduction of world-class expertise, technology, and best practices—and the importance of removing remaining obstacles to greater access.

  Foreign investors in Chinese banks remain limited to 20 percent ownership stakes, with total foreign investment limited to 25 percent. The China Securities Regulatory Commission (CSRC) continues to limit foreign ownership of Chinese securities firms to 33 percent and foreign ownership of Chinese asset management companies to 49 percent. Worse, since December of 2005, a de facto moratorium on foreign investments in Chinese securities firms has been imposed. Foreign life insurance companies remain limited to 50 percent ownership in joint ventures and all foreign insurers are limited to 25 percent equity ownership of existing domestic companies.

  While these caps were agreed to in the course of WTO accession negotiations, the limitations are among the most restrictive of any large emerging market nation and stand in the way of a level playing field for financial service providers. Most importantly, they limit access to the products, services, know-how, and expertise that China needs to sustain high rates of economic growth, and that China's businesses and citizens need to save, invest, and create and protect wealth. For these reasons, the United States and other WTO members have urged China to relax these limitations.

  China also continues to restrict access by foreign credit card companies. Banks in China are permitted to issue cards with a foreign logo only if they are co-branded with the logo of China Union Pay (CUP), an entity created by the PBOC and owned by participating Chinese banks. In addition, all yuan-denominated transactions must be processed through CUP's network, while the network of the foreign credit card company is used only to process foreign currency transactions.
- Non-discriminatory national treatment with regard to licensing, corporate form, and permitted products and services.

- Non-discriminatory national treatment with regard to regulation and supervision.
- Regulatory and procedural transparency.
- Attracting sophisticated institutional investors to China's capital markets through the expansion of the Qualified Foreign Institutional Investor (QFII) and Qualified Domestic Institutional Investor (QDII) programs.
- Priority issues from the Transitional Review Mechanism that remain unresolved.[8]

Conclusion

Mr. Chairman, the fastest way for China to develop the modern financial system it needs to achieve more sustainable economic growth, allow for a more flexible currency, and increase consumer consumption is to import it—that is, by opening its financial sector to greater participation by foreign financial services firms. Foreign institutions bring world-class expertise and best practices with regard to products and services, technology, credit analysis, risk management, internal controls, and corporate governance. In addition, the forces of competition brought by foreign institutions would accelerate the development of modern financial techniques and methodologies by China's financial institutions.

By providing the financial products and services that China's citizens and businesses need to save, invest, insure against risk, raise standards of living, and consume at higher levels, foreign financial institutions—including U.S. providers—would help China develop an economy that is less dependent on exports, more consumption-driven and, therefore, an enormously important and expanding market for American products and services. In doing so, U.S. financial services firms can help China become a more stable and responsible stakeholder in the global economy and trading system.

Thank you very much for the opportunity to appear at this important hearing.

Senator DORGAN. Mr. Nichols, thank you very much for being here.

Let me thank all of you for your testimony and appreciate the time you've taken to come. I'd like to ask a series of questions. Regrettably, Senator DeMint had to leave for another engagement. I appreciate his being here as well.

President Hoffa, let me ask you. You indicated you have just returned from a trip to China. Describe for me again the circumstances of what the Chinese government had advertised as some sort of effort to allow the creation of what appeared to be unions, but only unions that were government-sponsored or government-controlled unions of some type, and then the pushback by American firms against that and then the actions of the Chinese government? Would you describe that for me again?

Mr. HOFFA. We had a chance to meet with the ACFTU, which is the All China Federation of Trade Unions. It is the one union for all of China and it's sponsored by the communist government. It's part of the government. But they have chapters in every major city. They claim 122 million members.

They are working basically on what's called a contract labor law and it's something that is a reform. You have to understand, over there they don't have anywhere near the standard of living we do. These people are very, very poor, especially in the rural areas. They're very relatively primitive with regard to their lifestyles, and any kind of an uptick is good for them.

I do believe that the contract labor law was intended to try and stabilize working conditions with regard to hours of work, with re-

[8] China's WTO accession included the Transitional Review Mechanism (TRM) as a means for ongoing review of China's compliance with its obligations, and to provide those elements of the Chinese government supportive of further economic reform with information and evidence to urge full compliance with China's WTO commitments.

gard to some semblance of regulation on how hard you work, whether you have days off, the number of hours, the safety at work, job safety. It's not there, but at least it's a start.

What we found when we were over there was that the American Chamber of Commerce and all of the major companies—General Motors, Microsoft, all these big companies—are over there trying to water down these very basic improvements which were contained in the contract labor law, which I found absolutely appalling. First of all, the contract labor law was at least something, and then we see American corporations, which do have influence over there because they're 60 percent of what's being made there, are actually working with the government and doing everything they can to say we don't need this right now, leave us alone, we'll take care of it, as we've always heard from American business.

It was very indicative of even in China they're trying to keep the standard of living down as they profit. I thought that was appalling.

Senator DORGAN. Mr. Hoffa, thank you very much.

Mr. O'Shaughnessy, you indicated that the company that you run was owned by Paul Revere, so that has some history.

Mr. O'SHAUGHNESSY. Yes.

Senator DORGAN. Tell me about a Paul Revere-owned copper company? Describe to me what you now produce and describe the circumstances of the difficulty you have with China trade in specific relationship to your company's marketing and your company's production?

Mr. O'SHAUGHNESSY. OK. There has always been a member of the Revere family associated with Revere, and indeed the last full-time employee, Paul Revere, the fifth generation direct descendant, retired 10 years ago. His son Paul is an attorney that we use.

We produce sheet, strip, and coil products not unlike if you consider an aluminum rolling mill or a steel mill that produces these big coils of steel or aluminum. We would produce them made out of copper and brass. So our customers are OEMs, other manufacturing companies in the United States that take our product and produce other products. So for example, many of our customers used to be companies that made lock sets in California for doors. You know, you just go to any big box store now and you see that those are made in China. But of course the reason why they're made in China is because of currency manipulation.

Labor costs are not as big a factor as you think they are. Nucor makes the case that the cost of shipping a coil of steel from China to the United States is greater than the cost, the labor cost of producing that coil of steel in the United States.

Revere is the same situation. We see our customers disappearing because of China's currency manipulation.

Senator DORGAN. So because of currency manipulation your customer base has migrated to China?

Mr. O'SHAUGHNESSY. Correct.

Senator DORGAN. And they are customers of Chinese manufacturing rather than U.S. manufacturing?

Mr. O'SHAUGHNESSY. That's right. So they send over the products to the United States that used to be produced by our customers when they manufactured in the United States. When they moved to China, they no longer look for us as a source company to supply them.

Senator DORGAN. Let me, if I might, ask Mr. Nichols. You talked about the China economy and all of us understand the growth rate in China is substantial, 9, 10 percent. But you described China's economy as being number 10, 6, 4, perhaps number 2 at some point.

Isn't it the case, though, that you would better measure an economy on GDP per capita, how much are you producing per person? And by that measurement, my understanding is that China ranks 87th, somewhere behind Belize, Macedonia, and many, many others. So while one talks about the size of a country, one has to understand there are 1.4 plus billion Chinese and you allocate the production over the number of people and you have a per capita GDP that is really not very substantial at all. And you will grow this for many, many, many, many years before you get anywhere near reaching a U.S. per capita GDP number; is that not correct?

Mr. NICHOLS. Absolutely, Mr. Chairman. The broader point I was trying to make was simply that it's a deep market, it's a growing market. But certainly it is not a extremely sophisticated economy, which is in part why we're trying to achieve greater market access in there so they can start to consume and we can start to export more U.S. goods there.

Senator DORGAN. And that gets to the point that my colleague Senator DeMint made, and I respect that he's not here. But he was talking about Japan and how Japan has matured into a consumer economy. But it's also the case that it didn't matter much to us that Japan matured into a consumer economy. Last year the trade deficit with Japan was $88 billion because they're engaged in managed trade, not free trade, and they're very interested in having a very large trade surplus with us or we a deficit with them, and that's the way they manage their trade system.

So building a broad middle class and a consumer base in another country does not mean that our producers will necessarily have access to that and doesn't mean we won't have a very large trade deficit with a country if we're playing softball and they're playing hardball. If you have two different kinds of trade, ours a so-called chanting free trade and theirs is a managed trade economy with which they meet their objectives.

Mr. Spooner, you described—and I wanted to run these numbers by you—the robust boost in exports to China. But here are the numbers. We increased our exports to China from $41 billion to $55 billion from 2005 to 2006. That's correct? That's a pretty good increase, a $14 billion increase. The increase in imports from China was a $45 billion increase.

So understand that the increase in imports was triple our increase in exports. Now, I understand you used a percentage and I understand why people do that. But it really is a pretty meaningless percentage because you will never gain ground. You will always lose ground measuring it that way if in fact we're importing triple the quantity in real dollars of what we're exporting. Do you agree with that?

Mr. SPOONER. Mr. Chairman, I'd argue, though, that it's our responsibility not to manage trade, but to make sure the playing field is level. And we've heard testimony today about tax breaks or breaks to foreign invested enterprises in China, about export subsidies to Chinese companies, about dumping and subsidies and all those sort of unfair trade practices. And I'd argue that those are wrong and that the administration is aggressively attacking those challenges. We have WTO cases challenging tax breaks to FIEs, foreign invested enterprises, and have WTO cases challenging China's subsidies, and we've heard reference to furniture, paper, textiles, steel, shrimp, honey industries being hurt by unfair trade from China. Well, we have dumping orders protecting on behalf of all those domestic manufacturers.

Senator DORGAN. Yes, there has been some recent action there. The fact is we have not had the backbone we should have had all of these years. We'll see what happens on recent actions.

But my only point was that when we hear people say, gosh, we've got robust growth of exports to China, one has to look at the imports from China which are tripled in real dollars.

Let me make a point before I ask further questions. This hearing is not about, nor are my comments ever about, being anti-China. China is a big country. China is a country with whom we have substantial interactions and relationships that are very important. So it is portrayed sometimes as being anti-China, some giant adversarial relationship. The fact is I believe that our trade circumstances with China injure this country, are unfair to this country, and are advantageous to the Chinese. They know it. They manipulate it that way and we ought to go after it.

But the fact is we will always have, I think, a substantial amount of interaction with this big country and this important country, and it's important to understand the difference about what this hearing's about.

Mr. O'Shaughnessy, you wanted to make a comment.

Mr. O'SHAUGHNESSY. Yes. Part of the increase in our exports to China is the increase in scrap we ship over there. In other words, we're shipping over raw materials, select copper scrap. We're shipping over billions of dollars worth of copper scrap. Ten years ago we shipped over less than $100 million worth of copper scrap. So part of that export growth is not final manufactured products.

Senator DORGAN. You're right about that, Mr. O'Shaughnessy. I made an observation once that the largest export by volume from this country to Asia is waste paper, and *The Wall Street Journal,* some cute writer in *The Wall Street Journal,* said, well, so what? Well, so what? Well, it's the largest by volume export of our country, waste paper. It ought to tell you a little something about the circumstances and the problems that exist.

Mr. Paul, if I might and then I'll call on Mr. Hoffa. You wanted to make a comment. Mr. Paul, you described the work by Dr. Navarro from the University of California and you indicated that his recent study talked about the undercutting of prices by China, which has allowed their producers to have a dominant position. You indicated that lower labor costs account for 40 percent of the advantage, export subsidies 17 percent, undervalued currency 11 percent. These are at odds with Senator DeMint's comments and also Mr. O'Shaughnessy's comments, I think, in terms of what has been stated. I think Senator DeMint was saying that the regulations in this country play a large role. This study seems to suggest it is not a large role at all, it's a relatively small role.

Mr. O'Shaughnessy, you indicated you believe it is not labor costs that reflect the substantial difference. Mr. Paul, how do you respond to that?

Mr. PAUL. Well, I can explain the difference with Mr. O'Shaughnessy's comments. It depends on the industry you're looking at. In a resource-intensive industry like steel, the labor costs are going to be a smaller percentage of the output than, say, energy or raw materials. In a more labor-intensive occupation like assembly, labor costs are going to be higher. I think Dr. Navarro's study looked at a broad range of industries, but it certainly does not conflict in fact with what Mr. O'Shaughnessy argued.

The point that Dr. Navarro's study was making is that this is not the free market at work. It's not simply levels of development that are making Chinese products cheaper than the United States. Part of it is because of a direct government strategy to subsidize its domestic industry. Part of it is based on an enforcement regime which is nonexistent. Part of it is based on an artificially low labor cost based on, as President Hoffa pointed out, the denial of basic worker rights to the Chinese workforce, migration policies, and the nonenforcement of wage. Up to 80 or 85 percent of Chinese workers who should be getting the minimum wage are not in fact paid the minimum wage, and there are no consequences at all.

The point that the study was trying to make is that this is an artificial advantage that is market-distorting and it does not reflect the free market, and that's what we're up against. American companies can compete against foreign companies. They just can't compete against foreign governments.

Senator DORGAN. Thank you, Mr. Paul.

Mr. Hoffa?

Mr. HOFFA. I'd like to also make the comment, as you did, that my comments are not anti-China, because China is doing what's best for them. The answer is we're letting them do it. They're taking advantage of every crook in the law. They're doing whatever they're doing. They're doing it because they're very nationalistic, very mercantilistic. So that is their goal and there's nothing wrong with doing that.

But what are we doing to protect Americans? I think that's the flip side of it. We have basically lost that when we negotiate these agreements, to make agreements that are so one-sided, as you pointed out, a 2.5 percent tariff as opposed to 25 percent. It's ridiculous.

I'd like to make an observation that when I was in Shanghai we met with the American Chamber of Commerce. So here we are in China and we meet with a group of Americans that represent the Chamber of Commerce. Amongst them were at least four or five people, very bright, college-educated Americans, highly educated, very attractive people. And I said: What do you do? And they said: Well, we're consultants. Well, who do you consult with? We basically consult with American corporations that want to leave the United States and come to China, and we basically facilitate them finding a manufacturer to manufacture their product and to basically do everything we can so that they can have the connection to have their product made so it can be shipped back to the United States.

I think that was really a comment about what's going on, that these are Americans taking advantage of our laws with regard to basically moving jobs from the United States over there. These are American consultants dealing with American corporations, facilitating their leaving.

Also, as I talked about in my testimony, the fact is that we actually give subsidies to companies that leave the United States. That's got to come to an end.

The other point I'd like to make is when I was at the Port of Shanghai, it is amazing to see these ships go out loaded to the top with chain binders on containers so high you wonder if the ship is going to be able to make it to the United States. When the ships come back they are high out of the water, empty, with just a few containers on top. That basically tells you what the trade is.

When I was there I talked to the leaders, the people that ran that port, and I tried to get out of them what percentage of trade is export and import. They kept on dancing around. They really didn't want to tell me. The best I got out of them was 70–30 and I think it's a lot more than that. When you see these ships go out, that's the answer. It's empirical. You can see what's going out and when they come back they're empty.

Senator DORGAN. Mr. Hoffa, I have not talked about the companies, but there are many companies that have just closed shop in America and moved to China because China has become a low-cost offshore platform to produce for manufacturing. Huffy Bicycles are gone to China. In fact, the Huffy story is a fascinating story because it's a company that is now a, quote, "Chinese company." The actual corporate shell was sold to the Chinese. But people that made $11 an hour that made bicycles in this country; they're now made for 20 cents to 30 cents an hour. They're still sold in the same stores, Kmart, Walmart, Sears, and so on. And the Huffy workers all lost their jobs and the pensions for the Huffy workers have now been pawned off, as I understand it, to the U.S. Pension Benefit Guaranty Corporation, so the American taxpayers have the honor of paying pensions for a company that left for China.

But it's not just Huffy. It's Little Red Wagon, made in Chicago for 110 years, gone to China. The list goes on and on—Levi's, all-American Levi's; Fruit of the Loom. I won't ask who's wearing them here, but Fruit of the Loom underwear. You know, the fact is we could go on forever talking about this.

Mr. Hoffa, you are correct, there is a pernicious and unbelievable tax break that says fire your workers, close your plant, move to China, move anywhere out of the country, we'll give you a tax cut. I've tried four times to shut that down here in the U.S. Senate and failed four times. For my colleagues who might read this transcript, they should understand there will be a fifth, sixth, and seventh time, because one of these days I'm going to win. I got 42 votes the first time, I think 44 votes the last time. In 20 years I'll probably win this issue.

But we ought not under any circumstance provide tax breaks to those who are willing to move their jobs overseas. I mean, that's just, to use a word I used earlier, that is ignorant public policy in my judgment.

Mr. Nichols, and let me ask a couple others of you the same question. I've spoken to Warren Buffett a good many times about this subject. I've invited him in to meet with my colleagues on this subject. He has said and Mr. Greenspan, former Chairman of the Federal Reserve Board, has said that the current trade deficit is unsustainable. It is just unsustainable, and at some point when you get to where we are, over 5 percent of GDP and so on, at some point this thing's going to burst. Something's going to happen.

It is just as with respect to every bubble. The law of bubbles is that bubbles eventually burst. Just as it did with the housing boom. The question is when, not whether.

So Mr. Buffett has given a number of speeches. I don't know whether any of us have an idea of who's a better prognosticator of what works and what doesn't than Warren Buffett, but I'd like to hear any suggestions if there's a more informed or more successful investor over 30 years in this country than Warren Buffett. He warns that we are on an unsustainable path with respect to these trade deficits.

You're in the financial industry and review all of these things. Is it possible that one day someone will take a look at the fundamentals of all of this, the well over $1 trillion in combined real deficits per year at the Federal level, and say, wait a second, and then the electronic herd moves against our currency in a way that pulls the rug out from under and the stilts out from under our currency, and has dramatic consequences for our economy, and we stand around and all of us scratch our head and say, man, why did we not see that coming? Is that a possibility, or is that too pessimistic?

Mr. NICHOLS. I don't—I honestly don't know if that day would come. I certainly hope it does not come. There are—while I would say that generally speaking the underlying fundamentals of our economy today are reasonably sound, there are some things that we should think about, and you've pointed out some of those. For one, the trade imbalance, the deficit. It is a concern. It should be addressed. I've obviously outlined a way that we think we can address that successfully.

I would also note that we as a Nation need to save more. I mean, our savings rates, Mr. Chairman, I think are low, and that's also a concern. So while we're in a reasonably positive set of underlying fundamentals, there are some concerns, let alone—and you've done a lot of work on this and the hearing's not on it—but if we start talking about the unfunded liabilities, looking out 20, 30 years, our Nation's balance sheet has some significant concerns, as you well know better than almost anybody.

So that would be my kind of initial observation to your question. But I would just touch on a couple of things, going back to a couple of earlier points you made. One is, the imbalance with China which we want to address—and again, one way we think is to activate the consumer, and there are some estimates, Mr. Chairman, that there are roughly $2 trillion in what we'll call mattress money. That's just sitting in China. That's not being spent. We'd like them to stop saving that, consume that. Certainly some of the consumption would occur there, some would be in Europe, and some would be here, providing deeper markets for our exporters.

Senator DORGAN. Mr. Nichols, might I interrupt you——

Mr. NICHOLS. Yes, sir.

Senator DORGAN.—and excuse myself for doing it. But isn't it the case that, with respect to the middle class in China or whatever the class is that has this mattress money, as you describe it, isn't it also the case that the Chinese would very much want them to spend that money on Chinese manufactured goods? And take a look at Walmart in China. Walmart in China has mostly Chinese goods and the Chinese don't want American-produced goods in a Walmart in China.

Mr. NICHOLS. Right.

Senator DORGAN. So that's a serious problem in a trade relationship, isn't it?

Mr. NICHOLS. That's absolutely something that we need to pay attention to, that the people at USTR and Commerce and those in Congress focus on, absolutely.

I would simply—what I wanted to note was that we do have actually a surplus with China in the services area. It's small, $3 billion last year, but that was up roughly 27 percent from 2005. We'd like to see that grow certainly because roughly 80 percent of our GDP is in the services sector, and roughly the same percentage of our work force.

But no, we need to—there are a lot of things we need to do. Let me not suggest our trading relationship with China is perfectly rosy. There are a lot of things we need to do. But having them integrated fully into the global trading system I think is the right approach.

Senator DORGAN. Let me make one additional point and ask your response to it, perhaps to Mr. Hoffa and Mr. O'Shaughnessy especially. There are some who are part of the so-called "free traders," as they brand themselves—and branding is a very important activity these days, in the last 2 or 3 decades. That branding is assisted by institutions like *The Washington Post* that will carry only one side of the argument, one side of the debate.

So the branding has been successful, let me quickly admit. Free trade, that's wonderful, that's like tourism, that's all-American; and whatever the alternative is is some sort of isolationist, xenophobic stooge that just can't see over the horizon. You know, their thinking is back in the 1800s. So that's kind of the thoughtless approach to how the debate on trade has ensued.

But there are some who have swallowed all of this medicine on free trade and they say: You know what, it's a world economy, a global economy. You may not like it, but that's what it is. And if your workers, by God, can't compete, then shame on them, they deserve to lose their job. There are a billion and a half people around this world that are willing to work for 20 cents an hour. Good for them. Why shouldn't we move manufacturing there and have an opportunity for the consumers in this country to buy lower priced goods?

I mean, that's the argument. I think it's specious, but that's the argument by some. It seems to me—and I'll ask you this question. It seems to me that what that argument denies is a century of struggle to lift American standards and to say: Here's the standard for air, for water, for workers, for the way we want to allow people to organize. And to ignore those standards and to say whatever is around the world and it's a global economy, so let's access whatever parts of it we wish to.

Mr. Hoffa, you were just in China. I know you know and I certainly know the names of people who are sitting in prisons in China right now because they decided they wanted to form a labor union. For that they're put in prison.

So give me your response to this notion that to the extent that there are those of you who, I think Mr. O'Shaughnessy and Mr. Hoffa among the group, believe that there's a problem with this trade, you're kind of xenophobic here. What do you want to do, withdraw from the world? Don't you understand it's a global economy? I mean, that's what you'd be hit with.

Mr. HOFFA. Of course we hear that. But basically, other countries aren't buying into that. The European Union isn't buying into that. They protect their markets. We have to protect our standard of living, and one of the goals of any government is to protect their citizens. The fact that there's somebody that will work for less does not mean that everybody should lose their jobs, and that is part of what government is about. Not only do you provide water and police, but basically you provide a standard of living. That's why we have laws in this country. That's why we have a minimum wage. That's why we have supposedly good trade laws, which we haven't been doing. Basically, the job of America and all countries is to avoid this Darwinistic approach to trade, where if you can't compete you lose your job and they throw you in the street. In another time they would have thrown you into debtor's prison. Thank God we've moved from there.

But basically I think that people realize that this country has evolved where there are our standards that we are here, the government is to protect its employees and basically protect its citizens from unfair trade so that they can have the life they deserve.

Senator DORGAN. Mr. O'Shaughnessy, some of the free traders would say, you know what, tough luck, tough luck to you, you and your company, you can't keep up.

Mr. O'SHAUGHNESSY. Well, I'd say there's no such thing as free trade, at least in today's world. If American workers have to compete with workers who benefit from a 40 percent subsidy because of currency manipulation and a 17 percent VAT tax, you're adding up there almost a 60 percent cost difference. It has nothing to do with free trade. It has everything to do with the protectionism that China exhibits and practices and uses to develop its own internal industry.

This is not a textbook scholar, let's discuss and debate these issues. It's happening every day. Our workers can compete. They're highly productive, they're getting better every year, and we're producing better every year. But we cannot compete under that regime.

Think about this. How can a factory in the United States that has to pay the health care costs of its workers compete with a factory overseas that doesn't pay for the health care costs of its workers? So what this country needs in my opinion is a VAT tax that eliminates all taxes on jobs, plus a leveling of the playing field on currency manipulation, and then we will compete big time and we will be successful.

Senator DORGAN. Mr. O'Shaughnessy, I think that every trade agreement should have a shock absorber for currency manipulation and currency fluctuations. We did a trade agreement with Mexico and immediately following the trade agreement where the negotiators said they sweat blood because they were trying to reduce tariffs by 5, 10, 20 percent, immediately following that the peso was devalued 50 percent. So we lost ground rather than gained ground.

So I happen to think that every trade agreement ought to have some sort of a shock absorber with respect to the issue of currency fluctuation and manipulation.

Mr. Nichols?

Mr. NICHOLS. Mr. Chairman, if you'd indulge me, your thoughtful question is a perfect segue. With your permission, I'd like to enter something in the record. It's a report we just commissioned at the Financial Services Forum called "Succeeding in the Global Economy: A New Policy Agenda for the American Worker." It's essentially a study that we had commissioned. It just came out a couple of weeks ago and we briefed people in the House and Senate leadership about it. The point of the study simply, it makes the point that there are large massive gains due to trade. That said, there are dislocations associated with trade on the part of industries, regions, and individuals; and we need to come up with a new set of ideas for the private and public sector to work together to help those who are facing dislocations and not feeling and sharing in the full benefits of globalization.

So while there have been massive benefits to globalization in terms of better standards of living, lower cost of goods, things of that nature, there are some who are not feeling and sharing in the full benefits, and we need to help those people.

So with your permission, I'd like to enter our study into the record, please.

[The material referred to is retained in Committee files and is available at *http://www.financialservicesforum.org*.]

Senator DORGAN. We will do that. Without objection, the study may be made part of the record.

I was just thinking as you were speaking, Mr. Nichols, I appreciate your testimony because I think the testimony on the financial side is very important. But we use the term "dislocation." That's a euphemism for somebody losing their job, getting fired. It's somebody that comes home at night and says, "hey, Mildred, guess what. I got fired today. My job got moved to China because they closed the plant."

We call that dislocation, but it's much more serious. You know, the fact is we've got some mainstream economists—Alan Blinder, a mainstream economist, says that there are 42 to 56 million American jobs that are potentially, "tradeable." He says not all of them will be exported to low wage countries, but even those that remain here will have downward pressure on their income because others in other parts of the world would be able to do that job.

Now, what I think has happened is we have galloped along on globalization, but the rules have not kept pace. I believe this country has every right to decide here is the method or here is the way in which we will participate in the global economy. We will participate in the global economy in a way that helps lift others up, but we will not participate in a way that pushes us down. We spent a century building standards that have made this a great country and we will not spend the next decade trying to push down those standards in order to compete with conditions around the world which we should not be expected to compete with or against.

So those are the issues. I think we've covered many of them today. What we need to do as a Congress is try to evaluate what's happening, what is the cause of it, and what are the potential remedies. We have had a variety of opinions today. I very much appreciate the time you have taken to come and share with the Committee your thoughts. We'll have additional hearings and then we will have additional recommendations and legislative vehicles by which we try to address these issues.

This hearing is adjourned.

[Whereupon, at 4:18 p.m., the hearing was adjourned.]

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